This section includes the AICPA Code of Professional Conduct. It has been updated for all Official Releases through April 2006.

Introduction
Section 50 - Principles of Professional Conduct
Section 90 - Rules: Applicability and Definitions
Section 100 - Independence, Integrity, and Objectivity
Section 200 - General Standards Accounting Principles
Section 300 - Responsibilities to Clients
Section 400 - Responsibilities to Colleagues
Section 500 - Other Responsibilities and Practices
ET Appendixes
ET Topical Index

Composition, Applicability, and Compliance

The Code of Professional Conduct of the American Institute of Certified Public Accountants consists of two sections—(1) the Principles and (2) the Rules. The Principles provide the framework for the Rules, which govern the performance of professional services by members. The Council of the American Institute of Certified Public Accountants is authorized to designate bodies to promulgate technical standards under the Rules, and the bylaws require adherence to those Rules and standards.

The Code of Professional Conduct was adopted by the membership to provide guidance and rules to all members—their in public practice, in industry, in government, and in education—in the performance of their professional responsibilities.

Compliance with the Code of Professional Conduct, as with all standards in an open society, depends primarily on members' understanding and voluntary actions, secondarily on reinforcement by peers and public opinion, and ultimately on disciplinary proceedings, when necessary, against members who fail to comply with the Rules.

Other Guidance

Interpretations of Rules of Conduct consist of interpretations which have been adopted, after exposure to state societies, state boards, practice units and other interested parties, by the professional ethics division's executive committee to provide guidelines as to the scope and application of the Rules but are not intended to limit such scope or application. A member who departs from such guidelines shall have the burden of justifying such departure in any disciplinary hearing. Interpretations which existed before the adoption of the Code of Professional Conduct on January 12, 1988, will remain in effect until further action is deemed necessary by the appropriate senior technical committee.
Ethics Rulings consist of formal rulings made by the professional ethics division's executive committee after exposure to state societies, state boards, practice units and other interested parties. These rulings summarize the application of Rules of Conduct and Interpretations to a particular set of factual circumstances. Members who depart from such rulings in similar circumstances will be requested to justify such departures. Ethics Rulings which existed before the adoption of the Code of Professional Conduct on January 12, 1988, will remain in effect until further action is deemed necessary by the appropriate senior technical committee.

Publication of an Interpretation or Ethics Ruling in The Journal of Accountancy constitutes notice to members. Hence, the effective date of the pronouncement is the last day of the month in which the pronouncement is published in The Journal of Accountancy. The professional ethics division will take into consideration the time that would have been reasonable for the member to comply with the pronouncement.

A member should also consult, if applicable, the ethical standards of his state CPA society, state board of accountancy, the Securities and Exchange Commission, and any other governmental agency which may regulate his client's business or use his report to evaluate the client's compliance with applicable laws and related regulations.

Section 50 - Principles of Professional Conduct

51 - Preamble

Section 52 - Article I: Responsibilities

Section 53 - Article II: The Public Interest

Section 54 - Article III: Integrity

Section 55 - Article IV: Objectivity and Independence

Section 56 - Article V: Due Care

Section 57 - Article VI: Scope and Nature of Services
Membership in the American Institute of Certified Public Accountants is voluntary. By accepting membership, a certified public accountant assumes an obligation of self-discipline above and beyond the requirements of laws and regulations.

These Principles of the Code of Professional Conduct of the American Institute of Certified Public Accountants express the profession's recognition of its responsibilities to the public, to clients, and to colleagues. They guide members in the performance of their professional responsibilities and express the basic tenets of ethical and professional conduct. The Principles call for an unswerving commitment to honorable behavior, even at the sacrifice of personal advantage.

As professionals, certified public accountants perform an essential role in society. Consistent with that role, members of the American Institute of Certified Public Accountants have responsibilities to all those who use their professional services. Members also have a continuing responsibility to cooperate with each other to improve the art of accounting, maintain the public's confidence, and carry out the profession's special responsibilities for self-governance. The collective efforts of all members are required to maintain and enhance the traditions of the profession.
Article II—The Public Interest

Members should accept the obligation to act in a way that will serve the public interest, honor the public trust, and demonstrate commitment to professionalism.

.01

A distinguishing mark of a profession is acceptance of its responsibility to the public. The accounting profession’s public consists of clients, credit grantors, governments, employers, investors, the business and financial community, and others who rely on the objectivity and integrity of certified public accountants to maintain the orderly functioning of commerce. This reliance imposes a public interest responsibility on certified public accountants. The public interest is defined as the collective well-being of the community of people and institutions the profession serves.

.02

In discharging their professional responsibilities, members may encounter conflicting pressures from among each of those groups. In resolving those conflicts, members should act with integrity, guided by the precept that when members fulfill their responsibility to the public, clients’ and employers’ interests are best served.

.03

Those who rely on certified public accountants expect them to discharge their responsibilities with integrity, objectivity, due professional care, and a genuine interest in serving the public. They are expected to provide quality services, enter into fee arrangements, and offer a range of services—all in a manner that demonstrates a level of professionalism consistent with these Principles of the Code of Professional Conduct.

.04

All who accept membership in the American Institute of Certified Public Accountants commit themselves to honor the public trust. In return for the faith that the public repose in them, members should seek continually to demonstrate their dedication to professional excellence.
Article III—Integrity

To maintain and broaden public confidence, members should perform all professional responsibilities with the highest sense of integrity.

.01

Integrity is an element of character fundamental to professional recognition. It is the quality from which the public trust derives and the benchmark against which a member must ultimately test all decisions.

.02

Integrity requires a member to be, among other things, honest and candid within the constraints of client confidentiality. Service and the public trust should not be subordinated to personal gain and advantage. Integrity can accommodate the inadvertent error and the honest difference of opinion; it cannot accommodate deceit or subordination of principle.

.03

Integrity is measured in terms of what is right and just. In the absence of specific rules, standards, or guidance, or in the face of conflicting opinions, a member should test decisions and deeds by asking: "Am I doing what a person of integrity would do? Have I retained my integrity?" Integrity requires a member to observe both the form and the spirit of technical and ethical standards; circumvention of those standards constitutes subordination of judgment.

.04

Integrity also requires a member to observe the principles of objectivity and independence and of due care.

ET Section 55

Article IV—Objectivity and Independence
A member should maintain objectivity and be free of conflicts of interest in discharging professional responsibilities. A member in public practice should be independent in fact and appearance when providing auditing and other attestation services.

.01

Objectivity is a state of mind, a quality that lends value to a member's services. It is a distinguishing feature of the profession. The principle of objectivity imposes the obligation to be impartial, intellectually honest, and free of conflicts of interest. Independence precludes relationships that may appear to impair a member's objectivity in rendering attestation services.

.02

Members often serve multiple interests in many different capacities and must demonstrate their objectivity in varying circumstances. Members in public practice render attest, tax, and management advisory services. Other members prepare financial statements in the employment of others, perform internal auditing services, and serve in financial and management capacities in industry, education, and government. They also educate and train those who aspire to admission into the profession. Regardless of service or capacity, members should protect the integrity of their work, maintain objectivity, and avoid any subordination of their judgment.

.03

For a member in public practice, the maintenance of objectivity and independence requires a continuing assessment of client relationships and public responsibility. Such a member who provides auditing and other attestation services should be independent in fact and appearance. In providing all other services, a member should maintain objectivity and avoid conflicts of interest.

.04

Although members not in public practice cannot maintain the appearance of independence, they nevertheless have the responsibility to maintain objectivity in rendering professional services. Members employed by others to prepare financial statements or to perform auditing, tax, or consulting services are charged with the same responsibility for objectivity as members in public practice and must be scrupulous in their application of generally accepted accounting principles and candid in all their dealings with members in public practice.
Article V—Due Care

A member should observe the profession's technical and ethical standards, strive continually to improve competence and the quality of services, and discharge professional responsibility to the best of the member's ability.

.01

The quest for excellence is the essence of due care. Due care requires a member to discharge professional responsibilities with competence and diligence. It imposes the obligation to perform professional services to the best of a member's ability with concern for the best interest of those for whom the services are performed and consistent with the profession's responsibility to the public.

.02

Competence is derived from a synthesis of education and experience. It begins with a mastery of the common body of knowledge required for designation as a certified public accountant. The maintenance of competence requires a commitment to learning and professional improvement that must continue throughout a member's professional life. It is a member's individual responsibility. In all engagements and in all responsibilities, each member should undertake to achieve a level of competence that will assure that the quality of the member's services meets the high level of professionalism required by these Principles.

.03

Competence represents the attainment and maintenance of a level of understanding and knowledge that enables a member to render services with facility and acumen. It also establishes the limitations of a member's capabilities by dictating that consultation or referral may be required when a professional engagement exceeds the personal competence of a member or a member's firm. Each member is responsible for assessing his or her own competence—of evaluating whether education, experience, and judgment are adequate for the responsibility to be assumed.

.04

Members should be diligent in discharging responsibilities to clients, employers, and the public. Diligence imposes the responsibility to render services promptly and carefully, to be thorough, and to observe applicable technical and ethical standards.
Due care requires a member to plan and supervise adequately any professional activity for which he or she is responsible.

ET Section 57

Article VI—Scope and Nature of Services

A member in public practice should observe the Principles of the Code of Professional Conduct in determining the scope and nature of services to be provided.

The public interest aspect of certified public accountants' services requires that such services be consistent with acceptable professional behavior for certified public accountants. Integrity requires that service and the public trust not be subordinated to personal gain and advantage. Objectivity and independence require that members be free from conflicts of interest in discharging professional responsibilities. Due care requires that services be provided with competence and diligence.

Each of these Principles should be considered by members in determining whether or not to provide specific services in individual circumstances. In some instances, they may represent an overall constraint on the nonaudit services that might be offered to a specific client. No hard-and-fast rules can be developed to help members reach these judgments, but they must be satisfied that they are meeting the spirit of the Principles in this regard.

In order to accomplish this, members should

Practice in firms that have in place internal quality-control procedures to ensure that services are competently delivered and adequately supervised.
Determine, in their individual judgments, whether the scope and nature of other services provided to an audit client would create a conflict of interest in the performance of the audit function for that client.

Assess, in their individual judgments, whether an activity is consistent with their role as professionals.

[Revised May 15, 2000.]

Section 90 - Rules: Applicability and Definitions

Section 91 - Applicability [revised]

Section 92 - Definitions [revised]

ET Section 90

RULES: APPLICABILITY AND DEFINITIONS

ET Section 91

Applicability

As adopted
January 12, 1988,
unless otherwise indicated

.01

The bylaws of the American Institute of Certified Public Accountants require that members adhere to the Rules of the Code of Professional Conduct. Members must be prepared to justify departures from these Rules.

.02
Interpretation Addressing the Applicability of the AICPA Code of Professional Conduct. For purposes of the applicability section of the Code, a "member" is a member, associated member, or international associate of the American Institute of CPAs [ET section 92.20].

1. The Rules of Conduct that follow apply to all professional services performed except (a) where the wording of the rule indicates otherwise and (b) that a member who is practicing outside the United States will not be subject to discipline for departing from any of the rules stated herein as long as the member's conduct is in accord with the rules of the organized accounting profession in the country in which he or she is practicing. However, where a member's name is associated with financial statements under circumstances that would entitle the reader to assume that United States practices were followed, the member must comply with the requirements of rules 202 [ET section 202.01] and 203 [ET section 203.01].

2. A member shall not knowingly permit a person, whom the member has the authority or capacity to control, to carry out on his or her behalf, either with or without compensation, acts which, if carried out by the member, would place the member in violation of the rules. Further, a member may be held responsible for the acts of all persons associated with him or her in the practice of public accounting whom the member has the authority or capacity to control.

3. A member (as defined in ET section 92.20) or a covered member (as defined in ET section 92.06) may be considered to have his or her independence impaired, with respect to a client, as the result of the actions or relationships of certain persons or entities, as described in rule 101 [ET section 101.01] and its interpretations and rulings, whom the member or covered member does not have the authority or capacity to control. Therefore, nothing in this section should lead one to conclude that the member’s or covered member's independence is not impaired solely because of his or her inability to control the actions or relationships of such persons or entities.


ET Section 92

Definitions

As adopted,
January 12, 1988,
unless otherwise
indicated

[Pursuant to its authority under the bylaws (BL § 3.6.2.2) to interpret the Code of Professional Conduct, the Professional Ethics Executive Committee has issued the following definitions of terms appearing in the code effective November 30, 1989.]

.01

Attest engagement. An attest engagement is an engagement that requires independence as defined in AICPA Professional Standards.

[Revised November, 2001.]

.02

Attest engagement team. The attest engagement team consists of individuals participating in the attest engagement, including those who perform concurring and second partner reviews. The attest engagement team includes all employees and contractors retained by the firm who participate in the attest engagement, irrespective of their functional classification (for example, audit, tax, or management consulting services). The attest engagement team excludes specialists as discussed in SAS No. 73, Using the Work of a Specialist [AU section 336], and individuals who perform only routine clerical functions, such as word processing and photocopying.

[Revised November, 2001.]

.03

Client. A client is any person or entity, other than the member’s employer, that engages a member or a member’s firm to perform professional services or a person or entity with respect to which professional services are performed. For purposes of this paragraph, the term “employer” does not include—

a. Entities engaged in the practice of public accounting; or

b. Federal, state, and local governments or component units thereof provided the member performing professional services with respect to those entities—

i. Is directly elected by voters of the government or component unit thereof with respect to which professional services are performed; or

ii. Is an individual who is (1) appointed by a legislative body and (2) subject to removal by a legislative body; or

iii. Is appointed by someone other than the legislative body, so long as the appointment is confirmed by the legislative body and removal is subject to oversight or approval by the legislative body.
Close relative. A close relative is a parent, sibling, or nondependent child.

Council. The Council of the American Institute of Certified Public Accountants.

Covered member. A covered member is—

a. An individual on the attest engagement team;

b. An individual in a position to influence the attest engagement;

c. A partner or manager who provides nonattest services to the attest client beginning once he or she provides ten hours of nonattest services to the client within any fiscal year and ending on the later of the date (i) the firm signs the report on the financial statements for the fiscal year during which those services were provided or (ii) he or she no longer expects to provide ten or more hours of nonattest services to the attest client on a recurring basis;

d. A partner in the office in which the lead attest engagement partner primarily practices in connection with the attest engagement;

e. The firm, including the firm’s employee benefit plans; or

f. An entity whose operating, financial, or accounting policies can be controlled (as defined by generally accepted accounting principles [GAAP] for consolidation purposes) by any of the individuals or entities described in (a) through (e) or by two or more such individuals or entities if they act together.

Financial institution. A financial institution is considered to be an entity that, as part of its normal business operations, makes loans or extends credit to the general public. In addition, for automobile leases addressed under interpretation 101-5, Loans From
Financial Institution Clients [ET section 101.07], an entity would be considered a financial institution if it leases automobiles to the general public.

[Revised November, 2002 and September, 2003.]

.09

Financial statements. A presentation of financial data, including accompanying notes, if any, intended to communicate an entity’s economic resources and/or obligations at a point in time or the changes therein for a period of time, in accordance with generally accepted accounting principles or a comprehensive basis of accounting other than generally accepted accounting principles.

Incidental financial data to support recommendations to a client or in documents for which the reporting is governed by Statements on Standards for Attestation Engagements and tax returns and supporting schedules do not, for this purpose, constitute financial statements. The statement, affidavit, or signature of preparers required on tax returns neither constitutes an opinion on financial statements nor requires a disclaimer of such opinion.

.10

Firm. A firm is a form of organization permitted by law or regulation whose characteristics conform to resolutions of the Council of the American Institute of Certified Public Accountants that is engaged in the practice of public accounting. Except for purposes of applying Rule 101: Independence [ET section 101.01], the firm includes the individual partners thereof.

[Revised November, 2001.]

.11

Holding out. In general, any action initiated by a member that informs others of his or her status as a CPA or AICPA-accredited specialist constitutes holding out as a CPA. This would include, for example, any oral or written representation to another regarding CPA status, use of the CPA designation on business cards or letterhead, the display of a certificate evidencing a member’s CPA designation, or listing as a CPA in local telephone directories.

.12

Immediate family. Immediate family is a spouse, spousal equivalent, or dependent (whether or not related).

[Revised November, 2001.]

.13

Individual in a position to influence the attest engagement. An individual in a position to influence the attest engagement is one who—
a. Evaluates the performance or recommends the compensation of the attest engagement partner;

b. Directly supervises or manages the attest engagement partner, including all successively senior levels above that individual through the firm’s chief executive;

c. Consults with the attest engagement team regarding technical or industry-related issues specific to the attest engagement; or

d. Participates in or oversees, at all successively senior levels, quality control activities, including internal monitoring, with respect to the specific attest engagement.

[Revised November, 2001.]

14 Institute. The American Institute of Certified Public Accountants.

15 Interpretations of rules of conduct. Pronouncements issued by the division of professional ethics to provide guidelines concerning the scope and application of the rules of conduct.

16 Joint closely held investment. A joint closely held investment is an investment in an entity or property by the member and the client (or the client’s officers or directors, or any owner who has the ability to exercise significant influence over the client) that enables them to control (as defined by GAAP for consolidation purposes) the entity or property.

[Revised November, 2001.]

17 Key position. A key position is a position in which an individual:

a. Has primary responsibility for significant accounting functions that support material components of the financial statements;

b. Has primary responsibility for the preparation of the financial statements; or

c. Has the ability to exercise influence over the contents of the financial statements, including when the individual is a member of the board of directors or similar governing body, chief executive officer, president, chief financial officer, chief operating officer, general counsel, chief accounting officer, controller, director of internal audit, director of financial reporting, treasurer, or any equivalent position.
For purposes of attest engagements not involving a client’s financial statements, a key position is one in which an individual is primarily responsible for, or able to influence, the subject matter of the attest engagement, as described above.

[Revised November, 2001.]

18

Loan. A loan is a financial transaction, the characteristics of which generally include, but are not limited to, an agreement that provides for repayment terms and a rate of interest. A loan includes, but is not limited to, a guarantee of a loan, a letter of credit, a line of credit, or a loan commitment.

[Revised November, 2001.]

19

Manager. A manager is a professional employee of the firm who has either of the following responsibilities:

a. Continuing responsibility for the overall planning and supervision of engagements for specified clients.

b. Authority to determine that an engagement is complete subject to final partner approval if required.

[Revised November, 2001.]

20

Member. A member, associate member, or international associate of the American Institute of Certified Public Accountants.

21

Normal Lending Procedures, Terms, and Requirements. “Normal lending procedures, terms, and requirements” relating to a covered member’s loan from a financial institution are defined as lending procedures, terms, and requirements that are reasonably comparable with those relating to loans of a similar character committed to other borrowers during the period in which the loan to the covered member is committed. Accordingly, in making such comparison and in evaluating whether a loan was made under “normal lending procedures, terms, and requirements,” the covered member should consider all the circumstances under which the loan was granted, including

1. The amount of the loan in relation to the value of the collateral pledged as security and the credit standing of the covered member.

2. Repayment terms.

3. Interest rate, including "points."
4. Closing costs.

5. General availability of such loans to the public.

Related prohibitions that may be more restrictive are prescribed by certain state and federal agencies having regulatory authority over such financial institutions. Broker-dealers, for example, are subject to regulation by the Securities and Exchange Commission.

[Revised November, 2002.]

Office. An office is a reasonably distinct subgroup within a firm, whether constituted by formal organization or informal practice, where personnel who make up the subgroup generally serve the same group of clients or work on the same categories of matters. Substance should govern the office classification. For example, the expected regular personnel interactions and assigned reporting channels of an individual may well be more important than an individual’s physical location.

[Revised November, 2001.]

Partner. A partner is a proprietor, shareholder, equity or non-equity partner or any individual who assumes the risks and benefits of firm ownership or who is otherwise held out by the firm to be the equivalent of any of the aforementioned.

[Revised November, 2001.]

Period of the professional engagement. The period of the professional engagement begins when a member either signs an initial engagement letter or other agreement to perform attest services or begins to perform an attest engagement for a client, whichever is earlier. The period lasts for the entire duration of the professional relationship (which could cover many periods) and ends with the formal or informal notification, either by the member or the client, of the termination of the professional relationship or by the issuance of a report, whichever is later. Accordingly, the period does not end with the issuance of a report and recommence with the beginning of the following year's attest engagement.

[Revised November, 2001.]

Practice of public accounting. The practice of public accounting consists of the performance for a client, by a member or a member’s firm, while holding out as CPA(s), of the professional services of accounting, tax, personal financial planning, litigation support services, and those professional services for which standards are promulgated by
bodies designated by Council, such as Statements of Financial Accounting Standards, Statements on Auditing Standards, Statements on Standards for Accounting and Review Services, Statements on Standards for Consulting Services, Statements of Governmental Accounting Standards, and Statements on Standards for Attestation Engagements.

However, a member or a member’s firm, while holding out as CPA(s), is not considered to be in the practice of public accounting if the member or the member’s firm does not perform, for any client, any of the professional services described in the preceding paragraph.

Professional services. Professional services include all services performed by a member while holding out as a CPA.

Significant influence. The term significant influence is as defined in Accounting Principles Board Opinion No. 18 [AC section I82] and its interpretations.

[Revised November, 2001.]

ET Section 100 - Independence, Integrity, and Objectivity

ET Section 100.01 - Conceptual Framework for AICPA Independence Standards

ET Section 101 - Independence

Rule 101 - Independence
Interpretations Under Rule 101 - Independence

101-1—Interpretation of Rule 101 [Revised]
[101-1]—[Renumbered as interpretation 101-4]
101-2—Employment or Association with Attest Clients [Revised]
101-3—Performance of Nonattest Services [Revised]
101-4—Honorary Directorships and Trusteeships of Not-for-Profit Organization [Revised]
101-5—Loans From Financial Institution Clients and Related Terminology [Revised]
101-6—The Effect of Actual or Threatened Litigation on Independence [Revised]
[101-7]—[Deleted]
101-8—Effect on Independence of Financial Interests in Nonclients Having Investor or Investee Relationships With a Member's Client [Revised]
101-9—[101-9][Deleted]
101-10—The Effect on Independence of Relationships With Entities Included in the Governmental Financial Statements
101-11—Modified application of rule 101 for certain engagements to issue restricted-use reports under the Statements on Standards for Attestation Engagements [Revised]
101-12—Independence and Cooperative Arrangements With Clients
101-13—[Deleted]
101-14—The Effect of Alternative Practice Structures on the Applicability of Independence Rules
101-15—Financial Relationships
ET Section 102 - Integrity and Objectivity

Rule 102 - Integrity and Objectivity
Interpretations Under Rule 102 - Integrity and Objectivity

102-1—Knowing Misrepresentations in the Preparation of Financial Statements or records [Revised]
102-2—Conflicts of Interest
102-3—Obligations of a Member to His or Her Employer's External Accountant
102-4—Subordination of Judgment by a Member
102-5—Applicability of Rule 102 to Members Performing Educational Services
102-6—Professional Services Involving Client Advocacy
ET Section 191 - Ethics Rulings on Independence, Integrity, and Objectivity

[1.] Acceptance of a Gift [Deleted]
2. Association Membership [Revised]
[3.] Member as Signer or Co-signer of Checks [Deleted]
[4.] Payroll Preparation Services [Deleted]
[5.] Member as Bookkeeper [Deleted]
[6.] Member's Spouse as Accountant of Client [Deleted]
[7.] Member Providing Contract Services [Deleted]
8. Member Providing Advisory Services
9. Member as Representative of Creditor's Committee [Revised]
10. Member as Legislator [Revised]
11. Member as Executor or Trustee [Revised]
12. Member as Trustee of Charitable Foundation [Revised]
[13.] Member as Bank Stockholder [Deleted]
14. Member on Board of Federated Fund-Raising Organization
[15.] Retired Partner as Director [Deleted]
16. Member on Board of Directors of Nonprofit Social Club [Revised]
17. Member of Social Club
[18.] Member as City Council Chairman [Deleted]
19. Member on Deferred Compensation Committee [Revised]
20. Member Serving on Governmental Advisory Unit [Revised]
21. Member as Director and Auditor of the Entity's Profit Sharing Trust [Revised]
[22.] Family Relationship, Brother [Deleted]
[23.] Family Relationship, Uncle by Marriage [Deleted]
[24.] Family Relationship, Father [Deleted]
[25.] Family Relationship, Son [Deleted]
[26.] Family Relationship, Son [Deleted]
[27.] Family Relationship, Spouse as Trustee [Deleted]
[28.] Cash Account With Brokerage Client [Superseded by ethics ruling No. 59]
29. Member as Bondholder [Revised]
[30.] Financial Interest by Employee [Deleted]
31. Performance of Services for Common Interest Realty Associations (CIRAs), Including Cooperatives, Condominium Associations, Planned Unit Developments, Homeowners Associations, and Timeshare Developments [Revised]
[32.] Mortgage Loan to Member's Corporation [Deleted]
[33.] Member as Participant in Employee Benefit Plan [Deleted]
[34.] Member as Auditor of Common Trust Funds [Deleted]
[35.] Stockholder in Mutual Funds [Deleted]
[36.] Participant in Investment Club [Deleted]
[37.] Retired Partners as Co-Trustee [Deleted]
38. Member as Co-Fiduciary With Client Bank [Revised]
[39.] Member as Officially Appointed Stock Transfer Agent or Registrar [Deleted]
[40.] Controller Entering Public Practice [Deleted]
41. Financial Services Company Client Has Custody of a Members Assets
[42.] Member as Life Insurance Policy Holder [Deleted]
[43.] Member's Employee as Treasurer of a Client [Deleted]
[44.] Past Due Billings [Superseded by ethics ruling No. 52]
[45.] Past Due Fees: Client in Bankruptcy [Deleted]
[46.] Member as General Counsel[Superseded by ethics ruling No. 51]
[47.] Member as Auditor of Mutual Fund and Shareholder of Investment Advisor/Manager [Deleted]
48. Faculty Member as Auditor of a Student Fund [Revised]
[49.] Investor and Investee Companies [Superseded by interpretation 101-8]
[50.] Family Relationship, Brother-in-Law [Deleted]
[51]. Member Providing Legal Services [Deleted]
52. Unpaid Fees [Revised]
[53.] Member as Auditor of Employee Benefit Plan and Sponsoring Company [Deleted]
[54]. Member Providing Appraisal, Valuation, or Actuarial Services [Deleted]
[55.] Independence During Systems Implementation [Deleted]
[56.] Executive Search [Deleted]
[57.] MAS Engagement to Evaluate Service Bureaus [Deleted]
[58.] Member as Lessor [Deleted]
[59.] Account With Brokerage Client [Deleted]
60. Employee Benefit Plans—Member's Relationships With Participating Employer(s)
[61.] Participation of Member's Spouse in Client's Stock Ownership Plans (Including an ESOP) [Deleted]
[62.] Member and Client Are Limited Partners in a Limited Partnership [Deleted]
[63.] Review of Prospective Financial Information—Member's Independence of Promoters [Deleted]
64. Member on Board of Organization for Which Client Raises Funds [Revised]
65. Use of the CPA Designation by Member Not in Public Practice
66. Member's Retirement or Savings Plan Has Financial Interest in Client [Deleted]
67. Servicing of Loan
68. Blind Trust [Deleted]
69. Investment With a General Partner
70. Member's Depository Relationship With Client Financial Institution
71. Use of Nonindependent CPA Firm on an Engagement
72. Member on Advisory Board of Client
[73.] Meaning of the Period of a Professional Engagement [Deleted]
74. Audits, Reviews, or Compilations and a Lack of Independence
75. Membership in Client Credit Union
[76.] Guarantee of Loan [Deleted]
77. Individual Considering or Accepting Employment With the Client [Deleted]
[78.] Service on Governmental Board [Deleted]
[79.] Member's Investment in a Partnership That Invests in Member's Client [Deleted]
[80.] The Meaning of a Joint Closely Held Business Investment [Deleted]
81. Member's Investment in a Limited Partnership
82. Campaign Treasurer
[83.] Member on Board of Component Unit and Auditor of Oversight Entity [Deleted]
[84.] Member on Board of Material Component Unit and Auditor of Another Material Component Unit [Deleted]
85. Bank Director
[86.] Partially Secured Loans [Deleted]
[87.] Loan Commitment or Line of Credit [Deleted]
[88.] Loans to Partnership in Which Members are Limited Partners [Deleted]
[89.] Loan to Partnership in Which Members are General Partners [Deleted]
[90.] Credit Card Balances and Cash Advances [Deleted]
91. Member Leasing Property to or From a Client [Revised]
92. Joint Interest in Vacation Home
93. Service on Board of Directors of Federated Fund-Raising Organization
94. Indemnification Clause in Engagement Letters
95. Agreement With Attest Client to Use ADR Techniques
96. Commencement of ADR Proceeding
[97.] Performance of Certain Extended Audit Services [Deleted]
98. Member's Loan From a Nonclient Subsidiary or Parent of an Attest Client
99. Member Providing Services for Company Executives
100. Actions Permitted When Independence Is Impaired
101. Client Advocacy and Expert Witness Services
102. Indemnification of a Client
103. Attest Report on Internal Controls
104. Member Providing Operational Auditing Services [Deleted]
105. Frequency of Performance of Extended Audit Procedures [Deleted]
106. Member Has Significant Influence Over an Entity That Has Significant Influence Over a Client
107. Participation in Health and Welfare Plan of Client
[108.] Participation of Member or Spouse in Retirement, Savings, or Similar Plan Sponsored by, or That Invests in, Client [Deleted]
Introduction

1. This conceptual framework describes the risk-based approach to analyzing independence matters that is used by the Professional Ethics Executive Committee (PEEC) of the AICPA when it develops independence standards. Under that approach, a member’s relationship with a client is evaluated to determine whether it poses an unacceptable risk to the member’s independence. Risk is unacceptable if the relationship would compromise (or would be perceived as compromising by an informed third party having knowledge of all relevant information) the member’s professional judgment when rendering an attest service to the client. Key to that evaluation is identifying and assessing the extent to which a threat to the member’s independence exists and, if it does, whether it would be reasonable to expect that the threat would compromise the member’s professional judgment and, if so, whether it can be effectively mitigated or eliminated. Under the risk-based approach, steps are taken to prevent circumstances that threaten independence from compromising the professional judgments required in the performance of an attest engagement.

2. Professional standards of the AICPA require independence for all attest engagements. The PEEC bases its independence interpretations and rulings under ET section 100 of the AICPA’s Code of Professional Conduct on the concepts in this framework. However, in certain circumstances the PEEC has determined that it is appropriate to prohibit or restrict certain relationships notwithstanding the fact that the risk may be at an acceptable level. For example, the PEEC has determined that a covered member should not own even an immaterial direct financial interest in an attest client.

3. Because this conceptual framework describes the concepts upon which the AICPA’s independence interpretations and rulings are based, it may assist AICPA members and others in understanding those interpretations and rulings. In addition, this conceptual framework should be used by members when making decisions on independence matters that are not explicitly addressed by the Code of Professional Conduct. Under no circumstances, however, may the framework be used to overcome prohibitions or requirements contained in the independence interpretations and rulings.
4. The risk-based approach entails evaluating the risk that the member would not be independent or would be perceived by a reasonable and informed third party having knowledge of all relevant information as not being independent. That risk must be reduced to an acceptable level to conclude that a member is independent under the concepts in this framework. Risk is at an acceptable level when threats are at an acceptable level, either because of the types of threats and their potential effect, or because safeguards have sufficiently mitigated or eliminated the threats. Threats are at an acceptable level when it is not reasonable to expect that the threat would compromise professional judgment.

5. The risk-based approach involves the following steps.

Identifying and evaluating threats to independence—Identify and evaluate threats, both individually and in the aggregate, because threats can have a cumulative effect on a member’s independence. Where threats are identified but, due to the types of threats and their potential effects, such threats are considered to be at an acceptable level (that is, it is not reasonable to expect that the threats would compromise professional judgment), the consideration of safeguards is not required. If identified threats are not considered to be at an acceptable level, safeguards should be considered as described in paragraph 5(b).

Determining whether safeguards already eliminate or sufficiently mitigate identified threats and whether threats that have not yet been mitigated can be eliminated or sufficiently mitigated by safeguards—Different safeguards can mitigate or eliminate different types of threats, and one safeguard can mitigate or eliminate several types of threats simultaneously. When threats are sufficiently mitigated by safeguards, the threats’ potential to compromise professional judgment is reduced to an acceptable level. A threat has been sufficiently mitigated by safeguards if, after application of the safeguards, it is not reasonable to expect that the threat would compromise professional judgment.

Definitions

6. Independence is defined as:

Independence of mind—The state of mind that permits the performance of an attest service without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity and exercise objectivity and professional skepticism.

Independence in appearance—The avoidance of circumstances that would cause a reasonable and informed third party, having knowledge of all relevant information, including safeguards applied, to reasonably conclude that the integrity, objectivity, or professional skepticism of a firm or a member of the attest engagement team had been compromised.
7. This definition reflects the longstanding professional requirement that members who provide services to entities for which independence is required be independent both in fact and in appearance. The state of mind of a member who is independent “in fact” assists the member in performing an attest engagement in an objective manner. Accordingly, independence of mind reflects the longstanding requirement that members be independent in fact.

8. This definition is used as part of the risk-based approach to analyze independence. Because the risk-based approach requires judgment, the definition should not be interpreted as an absolute. For example, the phrase “without being affected by influences that compromise professional judgment” is not intended to convey that the member must be free of any and all influences that might compromise objective judgment. Instead, a determination must be made about whether such influences, if present, create an unacceptable risk that a member would not act with integrity and exercise objectivity and professional skepticism in the conduct of a particular engagement, or would be perceived as not being able to do so by a reasonable and informed third party that has knowledge of all relevant information.

9. Impair—For purposes of this framework, impair means to effectively extinguish (independence). When a member’s independence is impaired, the member is not independent.

10. Threats—Threats to independence are circumstances that could impair independence. Whether independence is impaired depends on the nature of the threat, whether it would be reasonable to expect that the threat would compromise the member’s professional judgment and, if so, the specific safeguards applied to reduce or eliminate the threat, and the effectiveness of those safeguards as described in paragraph 21.

11. Threats might not involve violations of existing interpretations or rulings. For example, the circumstance described in paragraph 18(b) of this framework is permissible in limited instances under current AICPA independence interpretations and rulings.

12. Many different circumstances (or combinations of circumstances) can create threats to independence. It is impossible to identify every situation that creates a threat. However, seven broad categories of threats should always be evaluated when threats to independence are being identified and assessed. They are self-review, advocacy, adverse interest, familiarity, undue influence, financial self-interest, and management participation threats. The following paragraphs define and provide examples, which are not all-inclusive, of each of these threat categories. Some of these examples are the subject of independence interpretations and rulings contained in the Code of Professional Conduct.

13. Self-review threat—Members reviewing as part of an attest engagement evidence that results from their own, or their firm’s, nonattest work such as, preparing source documents used to generate the client’s financial statements

14. Advocacy threat—Actions promoting an attest client’s interests or position.
Promoting the client’s securities as part of an initial public offering
Representing a client in U.S. tax court
15. Adverse interest threat—Actions or interests between the member and the client that are in opposition, such as, commencing, or the expressed intention to commence, litigation by either the client or the member against the other.

16. Familiarity threat—Members having a close or longstanding relationship with an attest client or knowing individuals or entities (including by reputation) who performed nonattest services for the client.

A member of the attest engagement team whose spouse is in a key position at the client, such as the client’s chief executive officer
A partner of the firm who has provided the client with attest services for a prolonged period
A member who performs insufficient audit procedures when reviewing the results of a nonattest service because the service was performed by the member’s firm
A member of the firm having recently been a director or officer of the client
A member of the attest engagement team whose close friend is in a key position at the client

17. Undue influence threat—Attempts by an attest client’s management or other interested parties to coerce the member or exercise excessive influence over the member.

A threat to replace the member or the member’s firm over a disagreement with client management on the application of an accounting principle
Pressure from the client to reduce necessary audit procedures for the purpose of reducing audit fees
A gift from the client to the member that is other than clearly insignificant to the member

18. Financial self-interest threat—Potential benefit to a member from a financial interest in, or from some other financial relationship with, an attest client.

Having a direct financial interest or material indirect financial interest in the client
Having a loan from the client, from an officer or director of the client, or from an individual who owns 10 percent or more of the client’s outstanding equity securities
Excessive reliance on revenue from a single attest client
Having a material joint venture or other material joint business arrangement with the client

19. Management participation threat—Taking on the role of client management or otherwise performing management functions on behalf of an attest client.

Serving as an officer or director of the client
Establishing and maintaining internal controls for the client
Hiring, supervising, or terminating the client’s employees

20. Safeguards—Controls that mitigate or eliminate threats to independence.
Safeguards range from partial to complete prohibitions of the threatening circumstance to
procedures that counteract the potential influence of a threat. The nature and extent of the safeguards to be applied depend on many factors, including the size of the firm and whether the client is a public interest entity. To be effective, safeguards should eliminate the threat or reduce to an acceptable level the threat’s potential to impair independence.

21. The effectiveness of a safeguard depends on many factors, including those listed here:

The facts and circumstances specific to a particular situation
The proper identification of threats
Whether the safeguard is suitably designed to meet its objectives
The party or parties that will be subject to the safeguard
How the safeguard is applied
The consistency with which the safeguard is applied
Who applies the safeguard

22. There are three broad categories of safeguards. The relative importance of a safeguard depends on its appropriateness in light of the facts and circumstances.

Safeguards created by the profession, legislation, or regulation
Safeguards implemented by the attest client
Safeguards implemented by the firm, including policies and procedures to implement professional and regulatory requirements

23. Examples of various safeguards within each category are presented in the following paragraphs. The examples are not intended to be all-inclusive and, conversely, the examples of safeguards implemented by the attest client and within the firm’s own systems and procedures may not all be present in each instance. In addition, threats may be sufficiently mitigated through the application of other safeguards not specifically identified herein.

24. Examples of safeguards created by the profession, legislation, or regulation

Education and training requirements on independence and ethics rules for new professionals
Continuing education requirements on independence and ethics
Professional standards and monitoring and disciplinary processes
External review of a firm’s quality control system
Legislation governing the independence requirements of the firm
Competency and experience requirements for professional licensure

25. Examples of safeguards implemented by the attest client that would operate in combination with other safeguards

The attest client has personnel with suitable skill, knowledge, and/or experience who make managerial decisions with respect to the delivery of nonattest services by the member to the attest client
A tone at the top that emphasizes the attest client’s commitment to fair financial reporting
Policies and procedures that are designed to achieve fair financial reporting
A governance structure, such as an active audit committee, that is designed to ensure appropriate decision making, oversight, and communications regarding a firm’s services
Policies that dictate the types of services that the entity can hire the audit firm to provide without causing the firm’s independence to be considered impaired

26. Examples of safeguards implemented by the firm

Firm leadership that stresses the importance of independence and the expectation that members of attest engagement teams will act in the public interest
Policies and procedures that are designed to implement and monitor quality control in attest engagements
Documented independence policies regarding the identification of threats to independence, the evaluation of the significance of those threats, and the identification and application of safeguards that can eliminate the threats or reduce them to an acceptable level
Internal policies and procedures that are designed to monitor compliance with the firm’s independence policies and procedures
Policies and procedures that are designed to identify interests or relationships between the firm or its partners and professional staff and attest clients
The use of different partners and engagement teams that have separate reporting lines in the delivery of permitted nonattest services to an attest client, particularly when the separation between reporting lines is significant
Training on and timely communication of a firm’s policies and procedures, and any changes to them, for all partners and professional staff
Policies and procedures that are designed to monitor the firm or partner’s reliance on revenue from a single client and, if necessary, cause action to be taken to address excessive reliance
Designating someone from senior management as the person who is responsible for overseeing the adequate functioning of the firm’s quality control system
A means of informing partners and professional staff of attest clients and related entities from which they must be independent
A disciplinary mechanism that is designed to promote compliance with policies and procedures
Policies and procedures that are designed to empower staff to communicate to senior members of the firm any engagement issues that concern them without fear of retribution
Policies and procedures relating to independence communications with audit committees or others charged with client governance
Discussing independence issues with the audit committee or others responsible for the client’s governance
Disclosures to the audit committee (or others responsible for the client’s governance) regarding the nature of the services that are or will be provided and the extent of the fees charged or to be charged
The involvement of another professional accountant who (1) reviews the work that is done for an attest client or (2) otherwise advises the attest engagement team (This individual
could be someone from outside the firm or someone from within the firm who is not otherwise associated with the attest engagement.)
Consultation on engagement issues with an interested third party, such as a committee of independent directors, a professional regulatory body, or another professional accountant
Rotation of senior personnel who are part of the attest engagement team
Policies and procedures that are designed to ensure that members of the attest engagement team do not make or assume responsibility for management decisions for the attest client
The involvement of another firm to perform part of the attest engagement
The involvement of another firm to reperform a nonattest service to the extent necessary to enable it to take responsibility for that service
The removal of an individual from an attest engagement team when that individual’s financial interests or relationships pose a threat to independence
A consultation function that is staffed with experts in accounting, auditing, independence, and reporting matters who can help attest engagement teams (1) assess issues when guidance is unclear, or when the issues are highly technical or require a great deal of judgment and (2) resist undue pressure from a client when the engagement team disagrees with the client about such issues
Client acceptance and continuation policies that are designed to prevent association with clients that pose an unacceptable threat to the member’s independence
Policies that preclude audit partners from being directly compensated for selling nonattest services to the audit client

[Issued April 2006, effective April 30, 2007, with earlier application encouraged, by the Professional Ethics Executive Committee.]

1 In cases where threats to independence are not at an acceptable level, thereby requiring the application of safeguards, the threats identified and the safeguards applied to eliminate the threats or reduce them to an acceptable level should be documented as required under “Other Considerations” of Interpretation No. 101-1, “Interpretation of Rule 101.”
2 The term safeguards is defined in paragraph 20.
3 ET section 55, Article IV – Objectivity and Independence, states, “A member in public practice should be independent in fact and appearance when providing auditing and other attestation services.”
4 This threat does not arise from testifying as a fact witness or defending the results of a professional service that the member performed for the client.
5 Solely for the purpose of this conceptual framework, the following entities are considered to be public interest entities: (1) entities subject to Securities and Exchange Commission reporting requirements; (2) employee benefit and health and welfare plans subject to Employee Retirement Income Security Act audit requirements; (3) governmental retirement plans; (4) entities or programs (including for-profit entities)
subject to Single Audit Act OMB Circular A-133 requirements and entities or programs subject to similar program oversight; and (5) financial institutions, credit unions, and insurance companies. These entities are public interest entities because their audited financial statements are directly relied upon by significant numbers of stakeholders to make investment, credit, or similar decisions (for example, in the case of a publicly held company) or indirectly relied upon through regulatory oversight (for example, in the case of pension plans, banks, and insurance companies) and, therefore, the potential extent of harm to the public from an audit failure involving one of these entities would generally be significant.

ET Section 101

Independence

.01

Rule 101—Independence. A member in public practice shall be independent in the performance of professional services as required by standards promulgated by bodies designated by Council.

[As adopted January 12, 1988.]

Interpretations under Rule 101

—Independence

In performing an attest engagement, a member should consult the rules of his or her state board of accountancy, his or her state CPA society, the Public Company Accounting Oversight Board and the U.S. Securities and Exchange Commission (SEC) if the member's report will be filed with the SEC, the U.S. Department of Labor (DOL) if the member's report will be filed with the DOL, the Government Accountability Office (GAO) if law, regulation, agreement, policy or contract requires the member's report to be filed under GAO regulations, and any organization that issues or enforces standards of independence that would apply to the member's engagement. Such organizations may have independence requirements or rulings that differ from (e.g., may be more restrictive than) those of the AICPA.

.02

101-1—Interpretation of Rule 101. Independence shall be considered to be impaired if:

A. During the period of the professional engagement of a covered member

1. Had or was committed to acquire any direct or material indirect financial interest in the client.

2. Was a trustee of any trust or executor or administrator of any estate if such trust or estate had or was committed to acquire any direct or material indirect financial interest in the client and

   (i) The covered member (individually or with others) had the authority to make investment decisions for the trust or estate; or

   (ii) The trust or estate owned or was committed to acquire more than 10 percent of the client's outstanding equity securities or other ownership interests; or
The value of the trust's or estate's holdings in the client exceeded 10 percent of the total assets of the trust or estate.

3. Had a joint closely held investment that was material to the covered member.

4. Except as specifically permitted in interpretation 101-5 [ET section 101.07], had any loan to or from the client, any officer or director of the client, or any individual owning 10 percent or more of the client’s outstanding equity securities or other ownership interests.

B. During the period of the professional engagement, a partner or professional employee of the firm, his or her immediate family, or any group of such persons acting together owned more than 5 percent of a client’s outstanding equity securities or other ownership interests.

C. During the period covered by the financial statements or during the period of the professional engagement, a firm, or partner or professional employee of the firm was simultaneously associated with the client as a(n) 1. Director, officer, or employee, or in any capacity equivalent to that of a member of management; 2. Promoter, underwriter, or voting trustee; or 3. Trustee for any pension or profit-sharing trust of the client.

**Transition Period for Certain Business and Employment Relationships**

A business or employment relationship with a client that impairs independence under interpretation 101-1.C [ET section 101.02], and that existed as of November 2001, will not be deemed to impair independence provided such relationship was permitted under rule 101 [ET section 101.01], and its interpretations and rulings as of November 2001, and the individual severed that relationship on or before May 31, 2002.

**Application of the Independence Rules to Covered Members Formerly Employed by a Client or Otherwise Associated With a Client**

An individual who was formerly (i) employed by a client or (ii) associated with a client as a(n) officer, director, promoter, underwriter, voting trustee, or trustee for a pension or profit-sharing trust of the client would impair his or her firm’s independence if the individual—

1. Participated on the attest engagement team or was an individual in a position to influence the attest engagement for the client when the attest engagement covers any period that includes his or her former employment or association with that client; or

2. Was otherwise a covered member with respect to the client unless the individual first dissociates from the client by—

   (a) Terminating any relationships with the client described in interpretation 101-1.C [ET section 101.02];

   (b) Disposing of any direct or material indirect financial interest in the client;

   (c) Collecting or repaying any loans to or from the client, except for loans specifically permitted or grandfathered under interpretation 101-5 [ET section 101.07];

   (d) Ceasing to participate in all employee benefit plans sponsored by the client, unless the client is legally required to allow the individual to participate in the plan (for example, COBRA) and the individual pays 100 percent of the cost of participation on a current basis; and

   (e) Liquidating or transferring all vested benefits in the client’s defined benefit plans, defined contribution plans, deferred compensation plans, and other similar arrangements at the earliest date permitted under the plan. However, liquidation or transfer is not required if a penalty significant to the benefits is imposed upon liquidation or transfer.
Application of the Independence Rules to a Covered Member's Immediate Family

Except as stated in the following paragraph, a covered member’s immediate family is subject to rule 101 (ET section 101.01), and its interpretations and rulings. The exceptions are that independence would not be considered to be impaired solely as a result of the following:

1. An individual in a covered member’s immediate family was employed by the client in a position other than a key position.

2. In connection with his or her employment, an individual in the immediate family of one of the following covered members participated in a retirement, savings, compensation, or similar plan that is a client, is sponsored by a client, or that invests in a client (provided such plan is normally offered to all employees in similar positions):
   a. A partner or manager who provides ten or more hours of non-attest services to the client; or
   b. Any partner in the office in which the lead attest engagement partner primarily practices in connection with the attest engagement.

For purposes of determining materiality under rule 101 (ET section 101.01) the financial interests of the covered member and his or her immediate family should be aggregated.

Application of the Independence Rules to Close Relatives

Independence would be considered to be impaired if—

1. An individual participating on the attest engagement team has a close relative who had
   a. A key position with the client, or
   b. A financial interest in the client that
      (i) Was material to the close relative and of which the individual has knowledge; or
      (ii) Enabled the close relative to exercise significant influence over the client.

2. An individual in a position to influence the attest engagement or any partner in the office in which the lead attest engagement partner primarily practices in connection with the attest engagement has a close relative who had
   a. A key position with the client; or
   b. A financial interest in the client that
      (i) Was material to the close relative and of which the individual or partner has knowledge; and
      (ii) Enabled the close relative to exercise significant influence over the client.

Grandfathered Employment Relationships

Employment relationships of a covered member’s immediate family and close relatives with an existing attest client that impair independence under this interpretation and that existed as of November 2001, will not be deemed to impair independence provided such relationships were permitted under preexisting requirements of rule 101 (ET section 101.01), and its interpretations and rulings.

Transition Period for Other Considerations
The provisions of the Conceptual Framework for AICPA Independence Standards [see ET section 100.01] and the related revision to “Other Considerations” of Interpretation No. 101-1 are effective for all independence decisions made as of April 30, 2007. Earlier application is encouraged.

Other Considerations fn 4

It is impossible to enumerate all circumstances in which the appearance of independence might be questioned. In the absence of an independence interpretation or ruling under Rule 101[see ET section 101.01] that addresses a particular circumstance, a members should evaluate whether that circumstance would lead a reasonable person aware of all the relevant facts to conclude that there is an unacceptable threat to the member’s and the firm’s independence. When making that evaluation, members should refer to the risk-based approach described in the Conceptual Framework for AICPA Independence Standards [see ET section 100.01]. If the threats to independence are not at an acceptable level, safeguards should be applied to eliminate the threats or reduce them to an acceptable level. In cases where threats to independence are not at an acceptable level, thereby requiring the application of safeguards, the threats identified and the safeguards applied to eliminate the threats or reduce them to an acceptable level should be documented. fn 2a


[Formerly paragraph .02 renumbered by adoption of the Code of Professional Conduct on January 12, 1988. Formerly interpretation 101-1, renumbered as 101-4 and moved to paragraph .06, April 1992.]

.04

The following Ethics Interpretation No. 101-2 reflects revisions made to the AICPA Code of Professional Conduct after April 16, 2003. As such, the following Ethics Interpretation No. 101-2 is not part of the standards adopted or established by the Public Company Accounting Oversight Board.

101-2—Employment or association with attest clients. A firm's independence will be considered to be impaired with respect to a client if a partner or professional employee leaves the firm and is subsequently employed by or associated with that client in a key position unless all the following conditions are met:

1. Amounts due to the former partner or professional employee for his or her previous interest in the firm and for unfunded, vested retirement benefits are not material to the firm, and the underlying formula used to calculate the payments remains fixed during the payout period. Retirement benefits may also be adjusted for inflation and interest may be paid on amounts due.

2. The former partner or professional employee is not in a position to influence the accounting firm's operations or financial policies.

3. The former partner or professional employee does not participate or appear to participate in, and is not associated with the firm, whether or not compensated for such participation or association, once employment or association with the client begins. An appearance of participation or association results from such actions as:

   • The individual provides consultation to the firm.
The firm provides the individual with an office and related amenities (for example, secretarial and telephone services).

- The individual's name is included in the firm's office directory.
- The individual's name is included as a member of the firm in other membership lists of business, professional, or civic organizations, unless the individual is clearly designated as retired.

4. The ongoing attest engagement team considers the appropriateness or necessity of modifying the engagement procedures to adjust for the risk that, by virtue of the former partner or professional employee's prior knowledge of the audit plan, audit effectiveness could be reduced.

5. The firm assesses whether existing attest engagement team members have the appropriate experience and stature to effectively deal with the former partner or professional employee and his or her work, when that person will have significant interaction with the attest engagement team.

6. The subsequent attest engagement is reviewed to determine whether the engagement team members maintained the appropriate level of skepticism when evaluating the representations and work of the former partner or professional employee, when the person joins the client in a key position within one year of disassociating from the firm and has significant interaction with the attest engagement team. The review should be performed by a professional with appropriate stature, expertise, and objectivity and should be tailored based on the position that the person assumed at the client, the position he or she held at the firm, the nature of the services he or she provided to the client, and other relevant facts and circumstances. Appropriate actions, as deemed necessary, should be taken based on the results of the review.

Responsible members within the firm should implement procedures for compliance with the preceding conditions when firm professionals are employed or associated with attest clients. With respect to conditions 4, 5, and 6, the procedures adopted will depend on several factors, including whether the former partner or professional employee served as a member of the engagement team, the positions he or she held at the firm and has accepted at the client, the length of time that has elapsed since the professional left the firm, and the circumstances of his or her departure.

Considering Employment or Association With the Client

When a member of the attest engagement team or an individual in a position to influence the attest engagement intends to seek or discuss potential employment or association with an attest client, or is in receipt of a specific offer of employment from an attest client, independence will be impaired with respect to the client unless the person promptly reports such consideration or offer to an appropriate person in the firm, and removes himself or herself from the engagement until the employment offer is rejected or employment is no longer being sought. When a covered member becomes aware that a member of the attest engagement team or an individual in a position to influence the attest engagement is considering employment or association with a client, the covered member should notify an appropriate person in the firm. The appropriate person should consider what additional procedures may be necessary to provide reasonable assurance that any work performed for the client by that person was performed with objectivity and integrity as required under rule 102 [ET section 102.01]. Additional procedures, such as reperformance of work already done, will depend on the nature of the engagement and the individual involved. [Replaces previous interpretation 101-2, Retired Partners and Firm Independence, August, 1989, effective August 31, 1989. Revised, effective December 31, 1998, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Revised, effective April 30, 2003, by the Professional Ethics Executive Committee.]

.05

The following Ethics Interpretation No. 101-3 reflects revisions made to the AICPA Code of Professional Conduct after April 16, 2003. As such, the following Ethics Interpretation No. 101-3 is not part of the standards adopted or established by the Public Company Accounting Oversight Board.

101-3—Performance of nonattest services. Before a member or his or her firm ("member") performs nonattest services (for example, tax or consulting services) for an attest client, the member should determine that the requirements described in this interpretation have been met. In cases where the requirements have not been met during the period of the professional engagement or the period covered by the financial statements, the member's independence would be impaired.
Engagements Subject to Independence Rules of Certain Regulatory Bodies

This interpretation requires compliance with independence regulations of authoritative regulatory bodies (such as the Securities and Exchange Commission [SEC], the General Accounting Office [GAO], the Department of Labor [DOL], and state boards of accountancy) where a member performs nonattest services for an attest client and is required to be independent of the client under the regulations of the applicable regulatory body. Accordingly, failure to comply with the nonattest services provisions contained in the independence rules of the applicable regulatory body that are more restrictive than the provisions of this interpretation would constitute a violation of this interpretation.

General Requirements for Performing Nonattest Services

1. The member should not perform management functions or make management decisions for the attest client. However, the member may provide advice, research materials, and recommendations to assist the client's management in performing its functions and making decisions.

2. The client must agree to perform the following functions in connection with the engagement to perform nonattest services:
   a. Make all management decisions and perform all management functions;
   b. Designate an individual who possesses suitable skill, knowledge, and/or experience, preferably within senior management, to oversee the services;
   c. Evaluate the adequacy and results of the services performed;
   d. Accept responsibility for the results of the services; and
   e. Establish and maintain internal controls, including monitoring ongoing activities.

The member should be satisfied that the client will be able to meet all of these criteria and make an informed judgment on the results of the member's nonattest services. In assessing whether the designated individual possesses suitable skill, knowledge, and/or experience, the member should be satisfied that such individual understands the services to be performed sufficiently to oversee them. However, the individual is not required to possess the expertise to perform or re-perform the services.

In cases where the client is unable or unwilling to assume these responsibilities (for example, the client does not have an individual with suitable skill, knowledge, and/or experience to oversee the nonattest services provided, or is unwilling to perform such functions due to lack of time or desire), the member's provision of these services would impair independence.

3. Before performing nonattest services, the member should establish and document in writing his or her understanding with the client (board of directors, audit committee, or management, as appropriate in the circumstances) regarding the following:
   a. Objectives of the engagement
   b. Services to be performed
   c. Client's acceptance of its responsibilities
   d. Member's responsibilities
   e. Any limitations of the engagement

The documentation requirement does not apply to:
   f. Nonattest services performed prior to January 1, 2005.
   g. Nonattest services performed prior to the client becoming an attest client.

General requirements 2 and 3 above do not apply to certain routine activities performed by the member such as providing advice and responding to the client's questions as part of the normal client-member relationship.
The following are some general activities that would impair a member’s independence:

- Authorizing, executing or consummating a transaction, or otherwise exercising authority on behalf of a client or having the authority to do so
- Preparing source documents, in electronic or other form, evidencing the occurrence of a transaction
- Having custody of client assets
- Supervising client employees in the performance of their normal recurring activities
- Determining which recommendations of the member should be implemented
- Reporting to the board of directors on behalf of management
- Serving as a client’s stock transfer or escrow agent, registrar, general counsel or its equivalent

Specific Examples of Nonattest Services

The examples in the following table identify the effect that performance of certain nonattest services for an attest client can have on a member’s independence. These examples presume that the general requirements in the previous section “General Requirements for Performing Nonattest Services” have been met and are not intended to be all-inclusive of the types of nonattest services performed by members.

<table>
<thead>
<tr>
<th>Type of Nonattest Service</th>
<th>Independence Would Not Be Impaired</th>
<th>Independence Would Be Impaired</th>
</tr>
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<tbody>
<tr>
<td>Bookkeeping</td>
<td>• Record transactions for which management has determined or approved the appropriate account classification, or post coded transactions to a client’s general ledger.</td>
<td>• Determine or change journal entries, account codings or classification for transactions, or other accounting records without obtaining client approval.</td>
</tr>
<tr>
<td></td>
<td>• Prepare financial statements based on information in the trial balance.</td>
<td>• Authorize or approve transactions.</td>
</tr>
<tr>
<td></td>
<td>• Post client-approved entries to a client’s trial balance.</td>
<td>• Prepare source documents.</td>
</tr>
<tr>
<td></td>
<td>• Propose standard, adjusting, or correcting journal entries or other changes affecting the financial statements to the client provided the client reviews the entries and the member is satisfied that management understands the nature of the proposed entries and the impact the entries have on the financial statements.</td>
<td>• Make changes to source documents without client approval.</td>
</tr>
<tr>
<td>Payroll and other disbursement</td>
<td>• Using payroll time records provided and approved by the client, generate unsigned checks, or process client’s payroll.</td>
<td>• Accept responsibility to authorize payment of client funds, electronically or otherwise, except as specifically provided for with respect to electronic payroll tax payments.</td>
</tr>
<tr>
<td></td>
<td>• Transmit client-approved payroll or other disbursement information to a financial institution provided the client has authorized the member to make the transmission and has made arrangements for the financial institution to limit the corresponding individual payments as to amount and payee. In addition, once transmitted, the client must authorize the financial institution.</td>
<td>• Accept responsibility to sign or cosign client checks, even if only in emergency situations.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Maintain a client’s bank account or otherwise have custody of a client’s funds or make credit or banking decisions for the client.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Sign payroll tax return on behalf of client management.</td>
</tr>
</tbody>
</table>
institution to process the information.

- Make electronic payroll tax payments in accordance with U.S. Treasury Department or comparable guidelines provided the client has made arrangements for its financial institution to limit such payments to a named payee. fn 8

Benefit plan administration fn 9

- Communicate summary plan data to plan trustee.
- Advise client management regarding the application or impact of provisions of the plan document.
- Process transactions (e.g., investment/benefit elections or increase/decrease contributions to the plan; data entry; participant confirmations; and processing of distributions and loans) initiated by plan participants through the member’s electronic medium, such as an interactive voice response system or Internet connection or other media.
- Prepare account valuations for plan participants using data collected through the member’s electronic or other media.
- Prepare and transmit participant statements to plan participants based on data collected through the member’s electronic or other medium.
- Make disbursements on behalf of the plan.
- Have custody of assets of a plan.
- Serve a plan as a fiduciary as defined by ERISA.

Investment—advisory or management

- Recommend the allocation of funds that a client should invest in various asset classes, depending upon the client’s desired rate of return, risk tolerance, etc.
- Perform recordkeeping and reporting of client’s portfolio balances including providing a comparative analysis of the client’s investments to third-party benchmarks.
- Review the manner in which a client’s portfolio is being managed by investment account managers, including determining whether the managers are (1) following the guidelines of the client’s investment policy statement; (2) meeting the client’s investment objectives; and (3) conforming to the client’s stated investment styles.
- Transmit a client’s investment selection to a broker-dealer or equivalent provided the client has authorized the broker-dealer or equivalent to execute the transaction.
- Make investment decisions on behalf of client management or otherwise have discretionary authority over a client’s investments.
- Execute a transaction to buy or sell a client’s investment.
- Have custody of client assets, such as taking temporary possession of securities purchased by a client.

Corporate finance—consulting or advisory

- Assist in developing corporate strategies.
- Commit the client to the terms of a transaction or consummate a
• Assist in identifying or introducing the client to possible sources of capital that meet the client’s specifications or criteria.
• Assist in analyzing the effects of proposed transactions including providing advice to a client during negotiations with potential buyers, sellers, or capital sources.
• Assist in drafting an offering document or memorandum.
• Participate in transaction negotiations in an advisory capacity.
• Be named as a financial adviser in a client’s private placement memoranda or offering documents.
• Maintain custody of client securities.

Executive or employee search

• Recommend a position description or candidate specifications.
• Solicit and perform screening of candidates and recommend qualified candidates to a client based on the client-approved criteria (e.g., required skills and experience).
• Participate in employee hiring or compensation discussions in an advisory capacity.

Business risk consulting

• Provide assistance in assessing the client’s business risks and control processes.
• Recommend a plan for making improvements to a client’s control processes and assist in implementing these improvements.
• Make or approve business risk decisions.
• Present business risk considerations to the board or others on behalf of management.

Information systems—design, installation or integration

• Install or integrate a client’s financial information system, that was not designed or developed by the member (e.g., an off-the-shelf accounting package).
• Assist in setting up the client’s chart of accounts and financial statement format with respect to the client’s financial information system.
• Design, develop, install, or integrate a client’s information system that is unrelated to the client's financial statements or accounting records.
• Design or develop a client’s financial information system.
• Make other than insignificant modifications to source code underlying a client’s existing financial information system.
• Supervise client personnel in the operation of a client’s information system.
• Operate a client’s local area network (LAN) system.

Appraisal, Valuation, and Actuarial Services

Independence would be impaired if a member performs an appraisal, valuation, or actuarial service for an attest client where the results of the service, individually or in the aggregate, would be material to the transaction on behalf of the client.

• Act as a promoter, underwriter, broker-dealer, or guarantor of client securities, or distributor of private placement memoranda or offering documents.
• Maintain custody of client securities.
financial statements and the appraisal, valuation, or actuarial service involves a significant degree of subjectivity. Valuations performed in connection with, for example, employee stock ownership plans, business combinations, or appraisals of assets or liabilities generally involve a significant degree of subjectivity. Accordingly, if these services produce results that are material to the financial statements, independence would be impaired.

An actuarial valuation of a client's pension or postemployment benefit liabilities generally produces reasonably consistent results because the valuation does not require a significant degree of subjectivity. Therefore, such services would not impair independence. In addition, appraisal, valuation, and actuarial services performed for nonfinancial statement purposes would not impair independence.

Internal Audit Assistance Services

Internal audit services involve assisting the client in the performance of its internal audit activities, sometimes referred to as “internal audit outsourcing.” In evaluating whether independence would be impaired with respect to an attest client, the nature of the service needs to be considered.

Assisting the client in performing financial and operational [fn11] internal audit activities would impair independence unless the member takes appropriate steps to ensure that the client understands its responsibility for establishing and maintaining the internal control system [fn12] and directing the internal audit function, including the management thereof. Accordingly, any outsourcing of the internal audit function to the member whereby the member in effect manages the internal audit activities of the client would impair independence.

In addition to the general requirements of this interpretation, the member should ensure that client management:

- Designates an individual or individuals, who possess suitable skill, knowledge, and/or experience, preferably within senior management, to be responsible for the internal audit function;
- Determines the scope, risk, and frequency of internal audit activities, including those to be performed by the member providing internal audit assistance services;
- Evaluates the findings and results arising from the internal audit activities, including those performed by the member providing internal audit assistance services; and
- Evaluates the adequacy of the audit procedures performed and the findings resulting from the performance of those procedures by, among other things, obtaining reports from the member.

The member should also be satisfied that the client's board of directors, audit committee, or other governing body is informed about the member's and management's respective roles and responsibilities in connection with the engagement. Such information should provide the client's governing body a basis for developing guidelines for management and the member to follow in carrying out these responsibilities and monitoring how well the respective responsibilities have been met.

The member is responsible for performing the internal audit procedures in accordance with the terms of the engagement and reporting thereon. The performance of such procedures should be directed, reviewed, and supervised by the member. The report should include information that allows the individual responsible for the internal audit function to evaluate the adequacy of the audit procedures performed and the findings resulting from the performance of those procedures. This report may include recommendations for improvements in systems, processes, and procedures. The member may assist the individual responsible for the internal audit function in performing preliminary audit risk assessments, preparing audit plans, and recommending audit priorities. However, the member should not undertake any responsibilities that are required, as described above, to be performed by the individual responsible for the internal audit function.
The following are examples of activities (in addition to those listed in the “General Activities” section of this interpretation) that, if performed as part of an internal audit assistance engagement, would impair independence:

- Performing ongoing monitoring activities or control activities (for example, reviewing loan originations as part of the client’s approval process or reviewing customer credit information as part of the customer’s sales authorization process) that affect the execution of transactions or ensure that transactions are properly executed, accounted for, or both, and performing routine activities in connection with the client’s operating or production processes that are equivalent to those of an ongoing compliance or quality control function
- Determining which, if any, recommendations for improving the internal control system should be implemented
- Reporting to the board of directors or audit committee on behalf of management or the individual responsible for the internal audit function
- Approving or being responsible for the overall internal audit work plan including the determination of the internal audit risk and scope, project priorities, and frequency of performance of audit procedures
- Being connected with the client as an employee or in any capacity equivalent to a member of client management (for example, being listed as an employee in client directories or other client publications, permitting himself or herself to be referred to by title or description as supervising or being in charge of the client’s internal audit function, or using the client’s letterhead or internal correspondence forms in communications)

The foregoing list is not intended to be all-inclusive.

Services involving an extension of the procedures that are generally of the type considered to be extensions of the member’s audit scope applied in the audit of the client’s financial statements, such as confirming of accounts receivable and analyzing fluctuations in account balances, are not considered internal audit assistance services and would not impair independence even if the extent of such testing exceeds that required by generally accepted auditing standards. In addition, engagements performed under the attestation standards would not be considered internal audit assistance services and therefore would not impair independence.

**Transition**

Independence would not be impaired as a result of the more restrictive requirements of interpretation 101-3, provided the provision of any such nonattest services are pursuant to arrangements in existence on December 31, 2003, and are completed by December 31, 2004, and the member was in compliance with the preexisting requirements of this interpretation.


.06

**101-4—Honorary directorships and trusteeships of not-for-profit organization.** Partners or professional employees of a firm (individual) may be asked to lend the prestige of their names to not-for-profit organizations that limit their activities to those of a charitable, religious, civic, or similar nature by being named as a director or a trustee. An individual who permits his or her name to be used in this manner would not be considered to impair independence under rule 101 [ET section 101.01] provided his or her position is clearly honorary, and he or she cannot vote or otherwise participate in board or management functions. If the individual is named in letterheads and externally circulated materials, he or she must be identified as an
honorary director or honorary trustee. [Formerly paragraph .05, renumbered by adoption of the Code of Professional Conduct on January 12, 1988. Formerly interpretation 101-1. Revised, effective June 30, 1990, by the Professional Ethics Executive Committee. Renumbered as interpretation 101-4 and moved from paragraph .03, April, 1992. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

.07

101-5—Loans from financial institution clients and related terminology. Interpretation 101-1.A.4 [ET section 101.02] provides that, except as permitted in this interpretation, independence shall be considered to be impaired if a covered member has any loan to or from a client, any officer or director of the client, or any individual owning ten percent or more of the client's outstanding equity securities or other ownership interests. This interpretation describes the conditions a covered member (or his or her immediate family) must meet in order to apply an exception for a "Grandfathered Loan" or "Other Permitted Loan."

Grandfathered Loans
Unsecured loans that are not material to the covered member's net worth, home mortgages, §14 and other secured loans §14 are grandfathered if:

(1) they were obtained from a financial institution under that institution's normal lending procedures, terms, and requirements,

(2) after becoming a covered member they are kept current as to all terms at all times and those terms do not change in any manner not provided for in the original loan agreement, §15 and

(3) they were:

a) obtained from the financial institution prior to its becoming a client requiring independence; or

b) obtained from a financial institution for which independence was not required and were later sold to a client for which independence is required; or

c) obtained prior to February 5, 2001 and met the requirements of previous provisions of Interpretation 101-5 [ET section 101.07] covering grandfathered loans; or

d) obtained between February 5, 2001 and May 31, 2002, and the covered member was in compliance with the applicable independence requirements of the SEC during that period; or

e) obtained after May 31, 2002 from a financial institution client requiring independence by a borrower prior to his or her becoming a covered member with respect to that client.

In determining when a loan was obtained, the date a loan commitment or line of credit is granted must be used, rather than the date a transaction closes or funds are obtained. For purposes of applying the grandfathered loans provision when the covered member is a partner in a partnership:

a loan to a limited partnership (or similar type of entity) or a general partnership would be ascribed to each covered member who is a partner in the partnership on the basis of their legal liability as a limited or general partner if:

o the covered member's interest in the limited partnership, either individually or combined with the interest of one or more covered members, exceeds 50 percent of the total limited partnership interest; or

o the covered member, either individually or together with one or more covered members, can control the general partnership.
even if no amount of a partnership loan is ascribed to the covered member(s) identified above, independence is considered to be impaired if the partnership renegotiates the loan or enters into a new loan that is not one of the permitted loans described below.

Other Permitted Loans
This interpretation permits only the following new loans and leases to be obtained from a financial institution client for which independence is required. These loans and leases must be obtained under the institution's normal lending procedures, terms, and requirements and must, at all times, be kept current as to all terms.

1. Automobile loans and leases collateralized by the automobile.
2. Loans fully collateralized by the cash surrender value of an insurance policy.
3. Loans fully collateralized by cash deposits at the same financial institution (e.g., "passbook loans").
4. Aggregate outstanding balances from credit cards and overdraft reserve accounts that are reduced to $10,000 or less on a current basis taking into consideration the payment due date and any available grace period.

Related prohibitions that may be more restrictive are prescribed by certain state and federal agencies having regulatory authority over such financial institutions. Broker-dealers, for example, are subject to regulation by the Securities and Exchange Commission.

Litigation between client and member
The relationship between the management of the client and a covered member must be characterized by complete candor and full disclosure regarding all aspects of the client's business operations. In addition, there must be an absence of bias on the part of the covered member so that he or she can exercise professional judgment on the financial reporting decisions made by the management. When the present management of a client company commences, or expresses an intention to commence, legal action against a covered member, the covered member and the client's management may be placed in adversarial positions in which the management's willingness to make complete disclosures and the covered member's objectivity may be affected by self-interest.

For the reasons outlined above, independence may be impaired whenever the covered member's client or its management are in threatened or actual positions of material adverse interests by reason of threatened or actual litigation. Because of the complexity and diversity of the situations of adverse interests which may arise, however, it is difficult to prescribe precise points at which independence may be impaired. The following criteria are offered as guidelines:

1. The commencement of litigation by the present management alleging deficiencies in audit work for the client would be considered to impair independence.
2. The commencement of litigation by the covered member against the present management alleging management fraud or deceit would be considered to impair independence.

3. An expressed intention by the present management to commence litigation against the covered member alleging deficiencies in audit work for the client would be considered to impair independence if the auditor concludes that it is probable that such a claim will be filed.

4. Litigation not related to performance of an attest engagement for the client (whether threatened or actual) for an amount not material to the covered member's firm\(^{16}\) or to the client company\(^ {16}\) would not generally be considered to affect the relationship in such a way as to impair independence. Such claims may arise, for example, out of disputes as to billings for services, results of tax or management services advice or similar matters.

Litigation by security holders
A covered member may also become involved in litigation ("primary litigation") in which the covered member and the client or its management are defendants. Such litigation may arise, for example, when one or more stockholders bring a stockholders' derivative action or a so-called "class action" against the client or its management, its officers, directors, underwriters and covered members under the securities laws. Such primary litigation in itself would not alter fundamental relationships between the client or its management and the covered member and therefore would not be deemed to have an adverse impact on independence. These situations should be examined carefully, however, since the potential for adverse interests may exist if cross-claims are filed against the covered member alleging that the covered member is responsible for any deficiencies or if the covered member alleges fraud or deceit by the present management as a defense. In assessing the extent to which independence may be impaired under these conditions, the covered member should consider the following additional guidelines:

1. The existence of cross-claims filed by the client, its management, or any of its directors to protect a right to legal redress in the event of a future adverse decision in the primary litigation (or, in lieu of cross-claims, agreements to extend the statute of limitations) would not normally affect the relationship between client management and the covered member in such a way as to impair independence, unless there exists a significant risk that the cross-claim will result in a settlement or judgment in an amount material to the covered member's firm\(^ {17}\) or to the client.

2. The assertion of cross-claims against the covered member by underwriters would not generally impair independence if no such claims are asserted by the client or the present management.

3. If any of the persons who file cross-claims against the covered member are also officers or directors of other clients of the covered member, independence with respect to such other clients would not generally be considered to be impaired.

Other third-party litigation
Another type of third-party litigation against the covered member may be commenced by a lending institution, other creditor, security holder, or insurance company who alleges reliance on financial statements of the client with which the covered member is associated as a basis for extending credit or insurance coverage to the client. In some instances, an insurance company may commence litigation (under subrogation rights) against the covered member in the name of the client to recover losses reimbursed to the client. These types of litigation would not normally affect independence with respect to a client who is either not the plaintiff or is only the nominal plaintiff, since the relationship between the covered member and client management would not be affected. They should be examined carefully, however, since the potential for adverse interests may exist if the covered member alleges, in his defense, fraud, or deceit by the present management.

If the real party in interest in the litigation (e.g., the insurance company) is also a client of the covered member ("the plaintiff client"), independence with respect to the plaintiff client may be impaired if the litigation involves a significant risk of a settlement or judgment in an amount which would be material to the covered member's firm\(^ {18}\) or to the plaintiff client.

Effects of impairment of independence
If the covered member believes that the circumstances would lead a reasonable person having knowledge of the facts to conclude that the actual or intended litigation poses an unacceptable threat to independence, the covered member should either (a) disengage himself or herself, or (b) disclaim an opinion because of
lack of independence. Such disengagement may take the form of resignation or cessation of any attest engagement then in progress pending resolution of the issue between the parties.

Termination of impairment
The conditions giving rise to a lack of independence are generally eliminated when a final resolution is reached and the matters at issue no longer affect the relationship between the covered member and client. The covered member should carefully review the conditions of such resolution to determine that all impairments to the covered member's objectivity have been removed.

[Formerly paragraph .07, renumbered by adoption of the Code of Professional Conduct on January 12, 1988. Revised, effective June 30, 1990, by the Professional Ethics Executive Committee. Revised, effective September 30, 1995, by the Professional Ethics Executive Committee, by deletion of subhead and paragraph and reissuance as ethics ruling No. 100, Actions Permitted When Independence is Impaired, under rule 101. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

[.09]

[101-7]—[Deleted]  [Formerly paragraph .08, renumbered by adoption of the Code of Professional Conduct on January 12, 1988.]

.10

101-8—Effect on independence of financial interests in nonclients having investor or investee relationships with a covered member's client.

Introduction

Financial interests in nonclients that are related in various ways to a client may impair independence. Situations in which the nonclient investor is a partnership are covered in other rulings [ET section 191.138–.139, .158–.159, and .162–.163].

Terminology

The following specifically identified terms are used in this interpretation as indicated:

1. Client. The term client means the person or entity with whose financial statements a covered member is associated.

2. Significant Influence. The term significant influence is as defined in Accounting Principles Board (APB) Opinion 18 [AC 182].

3. Investor. The term investor means (a) a parent, (b) a general partner, or (c) a natural person or corporation that has the ability to exercise significant influence.

4. Investee. The term investee means (a) a subsidiary or (b) an entity over which an investor has the ability to exercise significant influence.

Interpretation

Where a nonclient investee is material to a client investor, any direct or material indirect financial interest of a covered member in the nonclient investee would be considered to impair independence with respect to the client investor. If the nonclient investee is immaterial to the client investor, a covered member's material investment in the nonclient investee would cause an impairment of independence.
Where a client investee is material to nonclient investor, any direct or material indirect financial interest of a covered member in the nonclient investor would be considered to impair independence with respect to the client investee. If the client investee is immaterial to the nonclient investor, and if a covered member’s financial interest in the nonclient investor allows the covered member to exercise significant influence over the actions of the nonclient investor, independence would be considered to be impaired.

Where a client investee is material to nonclient investor, any direct or material indirect financial interest of a covered member in the nonclient investor would be considered to impair independence with respect to the client investee. If the client investee is immaterial to the nonclient investor, and if a covered member’s financial interest in the nonclient investor allows the covered member to exercise significant influence over the actions of the nonclient investor, independence would be considered to be impaired.

\[ \text{Client=“Investor”} \]
\[ \text{Nonclient=“Investee”} \]
Other relationships, such as those involving brother-sister common control or client-nonclient joint ventures, may affect the appearance of independence. The covered member should make a reasonable inquiry to determine whether such relationships exist, and if they do, careful consideration should be given to whether the financial interests in question would lead a reasonable observer to conclude that the specified relationships pose an unacceptable threat to independence.

In general, in brother-sister common control situations, an immaterial financial interest of a covered member in the nonclient investee would not impair independence with respect to the client investee, provided the covered member could not exercise significant influence over the nonclient investor. However, if a covered member's financial interest in a nonclient investee is material, the covered member could be influenced by the nonclient investor, thereby impairing independence with respect to the client investee. In like manner, in a joint venture situation, an immaterial financial interest of a covered member in the nonclient investor would not impair the independence of the covered member with respect to the client investor, provided that the covered member could not exercise significant influence over the nonclient investor.

If a covered member does not and could not reasonably be expected to have knowledge of the financial interests or relationship described in this interpretation, independence would not be considered to be impaired under this interpretation.

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<thead>
<tr>
<th>Is client material to nonclient?</th>
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<tbody>
<tr>
<td>No</td>
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<tr>
<td>Independence not impaired unless covered member's investment allows the covered member to exercise significant influence over nonclient.</td>
</tr>
<tr>
<td>Yes</td>
</tr>
<tr>
<td>Independence impaired if</td>
</tr>
<tr>
<td>a. Covered member has direct financial interest in nonclient; or</td>
</tr>
<tr>
<td>b. Covered member has material indirect financial interest in nonclient.</td>
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</table>

Nonclient="Investor"  
Client="Investee"
101-10—The effect on independence of relationships with entities included in the governmental financial statements. For purposes of this Interpretation, a financial reporting entity's basic financial statements, issued in conformity with generally accepted accounting principles in the United States of America, include the government-wide financial statements (consisting of the entity's governmental activities, business-type activities, and discretely presented component units), the fund financial statements (consisting of major funds, nonmajor governmental and enterprise funds, internal service funds, blended component units, and fiduciary funds) and other entities disclosed in the notes to the basic financial statements. Entities that should be disclosed in the notes to the basic financial statements include, but are not limited to, related organizations, joint ventures, jointly governed organizations, and component units of another government with characteristics of a joint venture or jointly governed organization.

Auditor of Financial Reporting Entity
A covered member issuing a report on the basic financial statements of the financial reporting entity must be independent of the financial reporting entity, as defined in paragraph 1 of this Interpretation. However, independence is not required with respect to any major or nonmajor fund, internal service fund, fiduciary fund, or component unit or other entities disclosed in the financial statements, where the primary auditor explicitly states reliance on other auditors reports thereon. In addition, independence is not required with respect to an entity disclosed in the notes to the basic financial statements, if the financial reporting entity is not financially accountable for the organization and the required disclosure does not include financial information. For example, a disclosure limited to the financial reporting entity's ability to appoint the governing board members would not require a member to be independent of that organization. However, the covered member and his or her immediate family should not hold a key position with a major fund, nonmajor fund, internal service fund, fiduciary fund, or component unit of the financial reporting entity or other entity that should be disclosed in the notes to the basic financial statements.

Auditor of a Major Fund, Nonmajor Fund, Internal Service Fund, Fiduciary Fund, or Component Unit of the Financial Reporting Entity or Other Entity That Should Be Disclosed in the Notes to the Basic Financial Statements
A covered member who is auditing the financial statements of a major fund, nonmajor fund, internal service fund, fiduciary fund, or component unit of the financial reporting entity or an entity that should be disclosed in the notes to the basic financial statements of the financial reporting entity, but is not auditing the primary government, should be independent with respect to those financial statements that the covered member is reporting upon. The covered member is not required to be independent of the primary government or other funds or component units of the reporting entity or entities that should be disclosed in the notes to the basic financial statements. However, the covered member and his or her immediate family should not hold a key position within the primary government. For purposes of this Interpretation, a covered member and immediate family member would not be considered employed by the primary government if the exceptions provided for in ET section 92.03 are met.

101-11—Modified application of rule 101 for certain engagements to issue restricted-use reports under the Statements on Standards for Attestation Engagements
Rule 101: Independence, and its interpretations and rulings apply to all attest engagements. However, for purposes of performing engagements to issue reports under the Statements on Standards for Attestation Engagements (SSAEs) that are restricted to identified parties, only the following covered members, and their immediate families, are required to be independent with respect to the responsible party in accordance with rule 101: Individuals participating on the attest engagement team;
• Individuals who directly supervise or manage the attest engagement partner; and
• Individuals who consult with the attest engagement team regarding technical or industry-related issues specific to the attest engagement.

In addition, independence would be considered to be impaired if the firm had a financial relationship covered by interpretation 101-1.A [ET section 101.02] with the responsible party that was material to the firm.

In cases where the firm provides non-attest services to the responsible party that are proscribed under interpretation 101-3 [ET section 101.05] and that do not directly relate to the subject matter of the attest engagement, independence would not be considered to be impaired.

In circumstances where the individual or entity that engages the firm is not the responsible party or associated with the responsible party, individuals on the attest engagement team need not be independent of the individual or entity, but should consider their responsibilities under interpretation 102-2 [ET section 102.03] with regard to any relationships that may exist with the individual or entity that engages them to perform these services.

This interpretation does not apply to an engagement performed under the Statements on Auditing Standards or Statements on Standards for Accounting and Review Services, or to an examination or review engagement performed under the Statements on Standards for Attestation Engagements.


101-12—Independence and cooperative arrangements with clients. Independence will be considered to be impaired if, during the period of a professional engagement, a member or his or her firm had any cooperative arrangement with the client that was material to the member's firm or to the client.

Cooperative Arrangement—A cooperative arrangement exists when a member's firm and a client jointly participate in a business activity. The following are examples, which are not all inclusive, of cooperative arrangements:

1. Prime/subcontractor arrangements to provide services or products to a third party
2. Joint ventures to develop or market products or services
3. Arrangements to combine one or more services or products of the firm with one or more services or products of the client and market the package with references to both parties
4. Distribution or marketing arrangements under which the firm acts as a distributor or marketer of the client's products or services, or the client acts as the distributor or marketer of the products or services of the firm

Nevertheless, joint participation with a client in a business activity does not ordinarily constitute a cooperative arrangement when all the following conditions are present:

a. The participation of the firm and the participation of the client are governed by separate agreements, arrangements, or understandings.

b. The firm assumes no responsibility for the activities or results of the client, and vice versa.

c. Neither party has the authority to act as the representative or agent of the other party.

In addition, the member's firm should consider the requirements of rule 302 [ET section 302.01] and rule 503 [ET section 503.01].

[Effective November 30, 1993. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]
The following Ethics Interpretation No. 101-13 reflects deletions made to the AICPA Code of Professional Conduct after April 16, 2003. As such, the following Ethics Interpretation No. 101-13 is not part of the standards adopted or established by the Public Company Accounting Oversight Board.

[101-13]—[Deleted]

.16

101-14 —The effect of alternative practice structures on the applicability of independence rules.

Because of changes in the manner in which members are structuring their practices, the AICPA's professional ethics executive committee (PEEC) studied various alternatives to "traditional structures" to determine whether additional independence requirements are necessary to ensure the protection of the public interest.

In many "nontraditional structures," a substantial (the nonattest) portion of a member's practice is conducted under public or private ownership, and the attest portion of the practice is conducted through a separate firm owned and controlled by the member. All such structures must comply with applicable laws, regulations, and Rule 505, Form of Organization and Name [ET section 505.01]. In complying with laws, regulations, and rule 505 [ET section 505.01], many elements of quality control are required to ensure that the public interest is adequately protected. For example, all services performed by members and persons over whom they have control must comply with standards promulgated by AICPA Council-designated bodies, and, for all other firms providing attest services, enrollment is required in an AICPA-approved practice-monitoring program.

Finally, and importantly, the members are responsible, financially and otherwise, for all the attest work performed. Considering the extent of such measures, PEEC believes that the additional independence rules set forth in this interpretation are sufficient to ensure that attest services can be performed with objectivity and, therefore, the additional rules satisfactorily protect the public interest.

Rule 505 [ET section 505.01] and the following independence rules for an alternative practice structure (APS) are intended to be conceptual and applicable to all structures where the "traditional firm" engaged in attest services is closely aligned with another organization, public or private, that performs other professional services. The following paragraph and the chart below provide an example of a structure in use at the time this interpretation was developed. Many of the references in this interpretation are to the example. PEEC intends that the concepts expressed herein be applied, in spirit and in substance, to variations of the example structure as they develop.

The example APS in this interpretation is one where an existing CPA practice ("Oldfirm") is sold by its owners to another (possibly public) entity ("PublicCo"). PublicCo has subsidiaries or divisions such as a bank, insurance company or broker-dealer, and it also has one or more professional service subsidiaries or divisions that offer to clients nonattest professional services (e.g., tax, personal financial planning, and management consulting). The owners and employees of Oldfirm become employees of one of PublicCo's subsidiaries or divisions and may provide those nonattest services. In addition, the owners of Oldfirm form a new CPA firm ("Newfirm") to provide attest services. CPAs, including the former owners of Oldfirm, own a majority of Newfirm (as to vote and financial interests). Attest services are performed by Newfirm and are supervised by its owners. The arrangement between Newfirm and PublicCo (or one of its subsidiaries or divisions) includes the lease of employees, office space and equipment; the performance of back-office functions such as billing and collections; and advertising. Newfirm pays a negotiated amount for these services.

**APS Independence Rules for Covered Members**

The term covered member in an APS includes both employed and leased individuals. The firm in such definition would be Newfirm in the example APS. All covered members, including the firm, are subject to rule 101 [ET section 101.01] and its interpretations and rulings in their entirety. For example, no covered member may have, among other things, a direct financial interest in or a loan to or from an attest client of Newfirm.

**Partners** of one Newfirm generally would not be considered partners of another Newfirm except in situations where those partners perform services for the other Newfirm or where there are significant shared economic interests between partners of more than one Newfirm. If, for example, partners of Newfirm 1 perform services in Newfirm 2, such owners would be considered to be partners of both Newfirms for purposes of applying the independence rules.

**APS Independence Rules for Persons and Entities Other Than Covered Members**

As stated above, the independence rules normally extend only to those persons and entities included in the definition of covered member. This normally would include only the "traditional firm" (Newfirm in the example APS), those covered members who own or are employed by Newfirm, and entities controlled by one or more of such persons. Because of the close alignment in many APSs between persons and entities included in covered member and other persons and entities, to ensure the protection of the public interest,
PEEC believes it appropriate to require restrictions in addition to those required in a traditional firm structure. Those restrictions are divided into two groups:

1. **Direct Superiors.** Direct Superiors are defined to include those persons so closely associated with a partner or manager who is a covered member, that such persons can *directly control* the activities of such partner or manager. For this purpose, a person who can *directly control* is the immediate superior of the partner or manager who has the power to direct the activities of that person so as to be able to directly or indirectly (e.g., through another entity over which the Direct Superior can exercise significant influence) derive a benefit from that person's activities. Examples would be the person who has day-to-day responsibility for the activities of the partner or manager and is in a position to recommend promotions and compensation levels. This group of persons is, in the view of PEEC, so closely aligned through direct reporting relationships with such persons that their interests would seem to be inseparable. Consequently, persons considered Direct Superiors, and entities within the APS over which such persons can exercise significant influence, are subject to rule 101 [ET section 101.01] and its interpretations and rulings in their entirety.

2. **Indirect Superiors and Other PublicCo Entities.** Indirect Superiors are those persons who are one or more levels above persons included in Direct Superior. Generally, this would start with persons in an organization structure to whom Direct Superiors report and go up the line from there. PEEC believes that certain restrictions must be placed on Indirect Superiors, but also believes that such persons are sufficiently removed from partners and managers who are covered persons to permit a somewhat less restrictive standard. Indirect Superiors are not connected with partners and managers who are covered members through direct reporting relationships; there always is a level in between. The PEEC also believes that, for purposes of the following, the definition of Indirect Superior also includes the immediate family of the Indirect Superior.

PEEC carefully considered the risk that an Indirect Superior, through a Direct Superior, might attempt to influence the decisions made during the engagement for a Newfirm attest client. PEEC believes that this risk is reduced to a sufficiently low level by prohibiting certain relationships between Indirect Superiors and Newfirm attest clients and by applying a materiality concept with respect to financial relationships. If the financial relationship is not material to the Indirect Superior, PEEC believes that he or she would not be sufficiently financially motivated to attempt such influence particularly with sufficient effort to overcome the presumed integrity, objectivity and strength of character of individuals involved in the engagement.

Similar standards also are appropriate for Other PublicCo Entities. These entities are defined to include PublicCo and all entities consolidated in the PublicCo financial statements that are not subject to rule 101 [ET section 101.01] and its interpretations and rulings in their entirety.

The rules for Indirect Superiors and Other PublicCo Entities are as follows:

A. Indirect Superiors and Other PublicCo Entities may not have a relationship contemplated by interpretation 101-1.A [ET section 101.02] (e.g., investments, loans, etc.) with an attest client of Newfirm that is material. In making the test for materiality for financial relationships of an Indirect Superior, all the financial relationships with an attest client held by such person should be aggregated and, to determine materiality, assessed in relation to the person’s net worth. In making the materiality test for financial relationships of Other PublicCo Entities, all the financial relationships with an attest client held by such entities should be aggregated and, to determine materiality, assessed in relation to the consolidated financial statements of PublicCo. In addition, any Other PublicCo Entity over which an Indirect Superior has direct responsibility cannot have a financial relationship with an attest client that is material in relation to the Other PublicCo Entity’s financial statements.

B. Further, financial relationships of Indirect Superiors or Other PublicCo Entities should not allow such persons or entities to exercise significant influence over the attest client. In making the test for significant influence, financial relationships of all Indirect Superiors and Other PublicCo Entities should be aggregated.

C. Neither Other PublicCo Entities nor any of their employees may be connected with an attest client of Newfirm as a promoter, underwriter, voting trustee, director or officer.

D. Except as noted in C above, Indirect Superiors and Other PublicCo Entities may provide services to an attest client of Newfirm that would impair independence if performed by Newfirm. For example, trustee and asset custodial services in the ordinary course of business by a bank subsidiary of PublicCo would be acceptable as long as the bank was not subject to rule 101 [ET section 101.01] and its interpretations and rulings in their entirety.

**Other Matters**
1. An example, using the chart below, of the application of the concept of Direct and Indirect Superiors would be as follows: The chief executive of the local office of the Professional Services Subsidiary (PSS), where the partners of Newfirm are employed, would be a Direct Superior. The chief executive of PSS itself would be an Indirect Superior, and there may be Indirect Superiors in between such as a regional chief executive of all PSS offices within a geographic area.

2. PEEC has concluded that Newfirm (and its partners and employees) may not perform an attest engagement for PublicCo or any of its subsidiaries or divisions.

3. PEEC has concluded that independence would be considered to be impaired with respect to an attest client of Newfirm if such attest client holds an investment in PublicCo that is material to the attest client or allows the attest client to exercise significant influence \^{fn26} over PublicCo.

4. When making referrals of services between Newfirm and any of the entities within PublicCo, a member should consider the provisions of Interpretation 102-2, Conflicts of Interest \^[ET section 102.03].

Alternative Practice Structure (APS) Model

![Diagram of financial relationships]

[Effective February 28, 1999; Revised, November 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

.17

101-15 – Financial relationships.

Financial Interests

Interpretation 101-1 \^[ET sec. 101.02A.1] states that independence shall be considered to be impaired if, during the period of the professional engagement, a covered member had or was committed to acquire any direct or material indirect financial interest in the client. When reviewing this interpretation, the covered member should also refer to interpretation 101-1 \^[ET sec. 101.02] for the application of rule 101 and its interpretations and rulings to the covered member’s immediate family and close relatives.

This interpretation provides definitions of direct and indirect financial interests and further guidance on whether various types of financial interests should be considered to be direct or indirect financial interests and provides certain limited exceptions under which a covered member could hold a direct or material indirect financial interest in an attest client without being considered to have impaired his or her independence.
Definitions

A **financial interest** is an ownership interest in an equity or a debt security issued by an entity, including rights and obligations to acquire such an interest and derivatives directly related to such interest.

A **direct financial interest** is a financial interest:

1. Owned directly by an individual or entity (including those managed on a discretionary basis by others); or
2. Under the control of an individual or entity (including those managed on a discretionary basis by others); or
3. Beneficially owned through an investment vehicle, estate, trust, or other intermediary when the beneficiary:
   a. Controls the intermediary; or
   b. Has the authority to supervise or participate in the intermediary’s investment decisions.

An **indirect financial interest** is a financial interest beneficially owned through an investment vehicle, estate, trust, or other intermediary when the beneficiary neither controls the intermediary nor has the authority to supervise or participate in the intermediary’s investment decisions.

A financial interest is **beneficially owned** when an individual or entity is not the record owner of the interest but has a right to some or all of the underlying benefits of ownership. These benefits include the authority to direct the voting or the disposition of the interest or to receive the economic benefits of the ownership of the interest.

Unsolicited Financial Interests

Independence would not be considered to be impaired if an unsolicited financial interest in a client is received, such as through gift or inheritance, and the financial interest is disposed of as soon as practicable, but no later than 30 days after the covered member has knowledge of and the right to dispose of the financial interest. In addition, when the covered member becomes aware that he or she will receive or has received a material direct or material indirect financial interest in a client requiring independence but does not have the right to dispose of the financial interest, independence would be considered to be impaired unless the covered member does not participate on the attest engagement team and disposes of the financial interest as soon as practicable but no later than 30 days after the right to dispose exists.

Mutual Funds

The ownership of shares in a mutual fund is considered to be a direct financial interest in the mutual fund. The underlying investments of a mutual fund are considered to be indirect financial interests.

If the mutual fund is diversified, a covered member’s ownership of 5 percent or less of the outstanding shares of the mutual fund would not be considered to constitute a material indirect financial interest in the underlying investments.

If a covered member owns more than 5 percent of the outstanding shares of a diversified mutual fund, or if the mutual fund is not diversified, the covered member should evaluate the underlying investments of the mutual fund to determine whether the covered member holds a material indirect financial interest in any of the underlying investments.

For example, if a nondiversified mutual fund owns shares in attest client Company A, and

- The mutual fund’s net assets are $10,000,000;
- The covered member owns 1 percent of the outstanding shares of the mutual fund, having a value of $100,000; and
- The mutual fund has 10 percent of its assets invested in Company A;
the indirect financial interest of the covered member in Company A is $10,000 and this amount should be measured against the covered member’s net worth (including the net worth of his or her immediate family) to determine if it is material.

**Retirement, Savings, Compensation, or Similar Plans**

A covered member who participates in a retirement, savings, compensation, or similar plan is considered to have a direct financial interest in the plan.\(^29\)

Investments held by a retirement, savings, compensation, or similar plan sponsored by a covered member’s firm would be considered direct financial interests of the firm.

If a covered member controls a retirement, savings, compensation, or similar plan or has the ability to supervise or participate in the plan’s investment decisions, the investments held by the plan would be considered direct financial interests of the covered member. Otherwise, the underlying plan investments would be considered indirect financial interests of the covered member.

Investments held in a defined benefit plan would not be considered financial interests of the covered member unless the covered member is a trustee of the plan or otherwise has the ability to supervise or participate in the plan’s investment decisions because the benefits are not dependent upon investment performance.

The following examples illustrate these concepts:

1. If a covered member is a trustee of a retirement, savings, compensation, or similar plan or otherwise has the authority to supervise or participate in the plan’s investment decisions, the underlying investments would be considered to be direct financial interests of the covered member.

2. If investments in a defined contribution plan are participant directed, whereby a covered member selects his or her underlying plan investments or selects from investment alternatives offered by the plan, the covered member would be considered to have a direct financial interest in those investments.

3. If investments in a defined contribution plan are not participant directed and the covered member has no authority to supervise or participate in the plan’s investment decisions, the covered member would be considered to have an indirect financial interest in the underlying plan investments.

Also refer to ethics ruling no. 107, Participation in Health and Welfare Plan Sponsored by Client [ET sec. 191.214-.215], and interpretation 101-1, Interpretation of Rule 101 [ET sec. 101.02], subsections “Application of the Independence Rules to Covered Members Formerly Employed by a Client or Otherwise Associated With a Client,” “Application of the Independence Rules to a Covered Member’s Immediate Family,” and “Application of the Independence Rules to Close Relatives.”

**Section 529 Plans**\(^30\)

Section 529 plans are sponsored by states or higher education institutions, and may be prepaid tuition plans or savings plans. Both types of plans are established by an account owner for the benefit of a single beneficiary. The account owner may change the beneficiary at any time to another individual who is related to the previous beneficiary.

A covered member who is the account owner of a Section 529 prepaid tuition plan is considered to have a direct financial interest in the plan but not in the investments of the plan because the credits purchased represent an obligation of the state or educational institution to provide the education regardless of the investment performance of the plan or the cost of the education at the future date.

A covered member who is the account owner of a Section 529 savings plan is considered to have a direct financial interest in both the plan and the investments of the plan because he or she decides in which sponsor’s Section 529 savings plan to invest and prior to making the investment has access to information about the plan’s investments.
If a covered member invests in a Section 529 savings plan that does not hold financial interests in an attest client at the time of the investment, but the plan subsequently invests in an attest client, the covered member should (1) transfer the account to another sponsor’s Section 529 savings plan or (2) transfer the account to another account owner who is not a covered member. However, when the transfer of the account will result in a penalty or tax that is significant to the account, the covered member may continue to own the account until the account can be transferred without significant penalty or tax, provided the covered member does not participate on the attest engagement team and is not in a position to influence the attest engagement.

A covered member who is a beneficiary of a Section 529 account is not considered to have a financial interest in the plan or the investments of the plan because he or she does not own the account or possess any of the underlying benefits of ownership and the beneficiary’s only interest is to receive distributions from the account for qualified higher education expenses if and when they are authorized by the account owner.

Before becoming engaged to perform an attest engagement for a government or governmental entity that sponsors a Section 529 plan, covered members that are account owners of a Section 529 plan should consider the guidance in interpretation 101-10, The Effect on Independence of Relationships With Entities Included in the Governmental Financial Statements [ET sec. 101.12].

Trust Investments

When a covered member is a grantor of a trust, the trust and the underlying investments held by the trust are considered to be direct financial interests if the covered member retains the right to amend or revoke the trust, or otherwise has the authority to control the trust or to supervise or participate in the trust’s investment decisions. However, where the covered member does not have the authority to amend or revoke the trust or to supervise or participate in the trust’s investment decisions, he or she is not considered to have a financial interest in the trust or the underlying investments held by the trust.

When a covered member is a beneficiary of a trust, the trust is considered to be a direct financial interest of the covered member and the underlying investments held by the trust are considered to be indirect financial interests of the covered member. However, if the covered member controls the trust or supervises or participates in the investment decisions of the trust, the underlying investments held by the trust are considered to be direct financial interests of the covered member.

In a blind trust, the grantor is also the beneficiary, but does not supervise or participate in the trust’s investment decisions during the term of the trust. However, the investments will ultimately revert to the grantor, and the grantor usually retains the right to amend or revoke the trust. Therefore, both the blind trust and the underlying investments held in a blind trust are considered to be direct financial interests of the covered member.

See interpretation 101-1 [ET sec. 101.02A.2] and ethics ruling no. 11 [ET sec. 191.021-.022] for additional guidance on trustee relationships.

Partnerships

The ownership of a general or limited partnership interest is considered a direct financial interest in the partnership.

The financial interests held by a partnership are considered to be direct financial interests of a covered member that is a general partner because the covered member is in a position to control the partnership or to supervise or participate in the partnership’s investment decisions.

The financial interests held by a limited partnership are considered to be indirect financial interests of a covered member who is a limited partner as long as the covered member does not control the partnership or supervise or participate in the partnership’s investment decisions. However, if the covered member has the ability to replace the general partner or has the authority to supervise or participate in the partnership’s
Investment decisions, the financial interests of the partnership would be considered to be direct financial interests of the covered member.

See interpretation 101-1 [ET sec. 101.02A.3] for additional guidance on joint closely held investments and interpretation 101-8 [ET sec. 101.10] for additional guidance on financial interests in nonclients having investor or investee relationships with a covered member.

**Limited Liability Companies**

The ownership of an interest in a limited liability company (LLC) is considered a direct financial interest in the LLC.

In an LLC, members who are managers control the LLC and have the authority to supervise or participate in the LLC’s investment decisions. Accordingly, if a covered member is a manager of the LLC, the financial interests of the LLC are considered to be direct financial interests of the covered member. If a covered member is a member but not a manager of the LLC, the covered member should look to the operating agreement of the LLC to determine whether he or she can control the LLC or has the authority to supervise or participate in the investment decisions of the LLC. If the covered member does not control the LLC, or have the authority to supervise or participate in the LLC’s investment decisions, the financial interests held by the LLC would be considered to be indirect financial interests of the covered member.

**Insurance Products**

An insurance policy obtained from a stock or mutual insurance company that does not offer the policy holder an investment option is not considered to be a financial interest. Accordingly, if a covered member owns an insurance policy issued by an attest client, independence is not considered to be impaired, provided the policy does not offer the policy holder an investment option and the policy was purchased under the insurance company’s normal terms, procedures, and requirements. If a mutual insurance company begins the demutualization process, covered members who hold an insurance policy from the company should refer to the guidance contained in the “Unsolicited Financial Interests” section of this Interpretation.

Some insurance policies offer an investment option whereby the policy owner may choose to invest part of the cash value in a variety of underlying investments. The underlying investments of this type of insurance policy are considered to be a financial interest, and the covered member should apply the guidance in this interpretation to determine whether the underlying investments are direct or indirect financial interests. For example, if the covered member has the ability to select the underlying investments or the authority to supervise or participate in the investment decisions and the cash value of the insurance policy is invested in a mutual fund, the mutual fund is considered to be a direct financial interest and the underlying investments of the mutual fund are considered to be indirect financial interests.

See interpretation 101-1 [ET sec. 101.02A.3] for additional guidance on joint closely held investments and interpretation 101-8 [ET sec. 101.10] for additional guidance on financial interests in nonclients having investor or investee relationships with a covered member.

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**Footnotes (ET Section 101 — Independence):**

fn * Terms shown in boldface type upon first usage in this interpretation are defined in ET section 92, Definitions. [Footnote added, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

fn ‡ This sentence reflects generally accepted auditing standards modified by the AICPA after April 16, 2003. As such, this sentence is not part of the standards adopted or established by the Public Company Accounting Oversight Board.
See Ethics Ruling No. 107, “Participation in Health and Welfare Plan of Client” [ET section 191.214–215], for instances in which participation was the result of permitted employment of the individual’s spouse or spousal equivalent.

A penalty includes an early withdrawal penalty levied under the tax law but excludes other income taxes that would be owed or market losses that may be incurred as a result of the liquidation or transfer.

A failure to prepare the required documentation would be considered a violation of Rule 202, Compliance With Standards (AICPA, Professional Standards, vol. 2, ET sec. 202.01), of the AICPA Code of Professional Conduct. Independence would not be considered to be impaired provided the member can demonstrate that he or she did apply safeguards to eliminate unacceptable threats or reduce them to an acceptable level.

A failure to prepare the required documentation would be considered a violation of Rule 202, Compliance With Standards [ET section 202.01], of the AICPA Code of Professional Conduct. Independence would not be considered to be impaired provided the member can demonstrate that he or she did apply safeguards to eliminate unacceptable threats or reduce them to an acceptable level. [Footnote added, effective April 30, 2006, by the Professional Ethics Executive Committee.] *1

This footnote reflects generally accepted auditing standards modified by the AICPA after April 16, 2003. As such, this footnote is not part of the standards adopted or established by the Public Company Accounting Oversight Board.

A member who performs a compilation engagement for a client should modify the compilation report to indicate a lack of independence if the member does not meet all of the conditions set out in this interpretation when providing a nonattest service to that client (see Statement on Standards for Accounting and Review Services No. 1, Compilation and Review of Financial Statements [AR section 100.19]). [Footnote added, effective December 31, 2003, by the Professional Ethics Executive Committee.] *1

A failure to prepare the required documentation would not impair independence, but would be considered a violation of Rule 202 - Compliance with Standards, provided that the member did establish the understanding with the client. [Footnote added, effective December 31, 2003, by the Professional Ethics Executive Committee. Footnote subsequently revised January 27, 2005.] *1

However, upon the acceptance of an attest engagement, the member should prepare written documentation demonstrating his or her compliance with the other general requirements during the period covered by the financial statements, including the requirement to establish an understanding with the client. [Footnote added, effective October 31, 2004, by the Professional Ethics Executive Committee.] *1

Source documents are the documents upon which evidence of an accounting transaction are initially recorded. Source documents are often followed by the creation of many additional records and reports, which do not, however, qualify as initial recordings. Examples of source documents are purchase orders, payroll time cards, and customer orders. [Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered and revised, September 2003, by the Professional Ethics Executive Committee. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2004.] *1

Although this type of transaction may be considered by some to be similar to signing checks or disbursing funds, the Professional Ethics Executive Committee concluded that making electronic payroll tax payments under the specified criteria would not impair a member’s independence. [Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, September, 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2004.] *1

When auditing plans subject to the Employee Retirement Income Security Act (ERISA), Department of Labor (DOL) regulations, which may be more restrictive, must be followed. [Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, September 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2004.] *1
10 Examples of such services may include appraisal, valuation, and actuarial services performed for tax planning or tax compliance, estate and gift taxation, and divorce proceedings. [Footnote added, effective December 31, 2003, by the Professional Ethics Executive Committee. Footnote renumbered by the Professional Ethics Executive Committee, July 2004.]  

11 For example, a member may assess whether performance is in compliance with management's policies and procedures, to identify opportunities for improvement, and to develop recommendations for improvement or further action for management consideration and decision making. [Footnote added, effective December 31, 2003, by the Professional Ethics Executive Committee. Footnote renumbered by the Professional Ethics Executive Committee, July 2004.]  

12 As part of its responsibility to establish and maintain internal control, management monitors internal control to assess the quality of its performance over time. Monitoring can be accomplished through ongoing activities, separate evaluations, or a combination of both. Ongoing monitoring activities are the procedures designed to assess the quality of internal control performance over time and built into the normal recurring activities of an entity; they include regular management and supervisory activities, comparisons, reconciliations, and other routine actions. Separate evaluations focus on the continued effectiveness of a client's internal control. A member's independence would not be impaired by the performance of separate evaluations of the effectiveness of a client's internal control, including separate evaluations of the client's ongoing monitoring activities. [Footnote added, effective December 31, 2003, by the Professional Ethics Executive Committee. Footnote renumbered by the Professional Ethics Executive Committee, July 2004.]  

14 Terms shown in boldface type upon first usage in this interpretation are defined in ET section 92. Definitions.  

14 The value of the collateral securing a home mortgage or other secured loan should equal or exceed the remaining balance of the grandfathered loan during the term of the loan. If the value of the collateral is less than the remaining balance of the grandfathered loan, the portion of the loan that exceeds the value of the collateral must not be material to the covered member's net worth. [Footnote added, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, September 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2004.]  

15 Changes in the terms of the loan include, but are not limited to, a new or extended maturity date, a new interest rate or formula, revised collateral, or revised or waived covenants. [Footnote added, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, September 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2004.]  

14 This sentence reflects revisions made to the AICPA Code of Professional Conduct after April 16, 2003. As such, this sentence is not part of the standards adopted or established by the Public Company Accounting Oversight Board.  

16 Because of the complexities of litigation and the circumstances under which it may arise, it is not possible to prescribe meaningful criteria for measuring materiality; accordingly, the covered member should consider the nature of the controversy underlying the litigation and all other relevant factors in reaching a judgment. [Footnote renumbered and revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Footnote subsequently renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, September 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2004.]  


Except for a financial reporting entity’s basic financial statements, which is defined within the text of this Interpretation, certain terminology used throughout the Interpretation is specifically defined by the Governmental Accounting Standards Board. [Footnote renumbered, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Footnote subsequently renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, September 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2004.]


As defined in the SSAEs. [Footnote renumbered, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Footnote subsequently renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, September 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2004.]

Terms shown in **boldface** type upon first usage in this interpretation are defined in ET section 92, Definitions. [Footnote added, November 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

For purposes of this Interpretation, significant influence means having the ability to exercise significant influence over the financial, operating or accounting policies of the entity, for example by (1) being connected with the entity as a promoter, underwriter, voting trustee, general partner or director, (2) being in a policy-making position such as chief executive officer, chief operating officer, chief financial officer or chief accounting officer, or (3) meeting the criteria in Accounting Principles Board Opinion No. 18 [AC section I82] and its interpretations to determine the ability of an investor to exercise such influence with respect to an entity. The foregoing examples are not necessarily all-inclusive. [Footnote added, November 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, September 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2004.]

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When used herein, the term control includes situations where the covered member, individually or acting together with his or her firm or with other partners or professional employees of his or her firm, has the ability to exercise such control.

To determine if the mutual fund is diversified, the covered member should refer to (1) the mutual fund’s prospectus to see if the prospectus discloses that the fund is not diversified or (2) Section 5(b)(1) of the Investment Company Act of 1940.

A covered member who is an employee of a governmental organization that is required by law or regulation to audit a retirement plan sponsored by a governmental unit will be permitted to be a participant in the plan, provided the plan is offered to all employees in equivalent employment positions, and the covered member (1) is not associated with the plan in any capacity prohibited by interpretation 101-1.C; (2) has no influence or control over the investment strategy, benefits, or other management activities associated with the plan; and (3) is required to participate in the plan as a condition of employment.

However, a covered member who is an employee of a governmental organization that is required by law or regulation to audit a Section 529 plan sponsored by a governmental unit will be permitted to be an account owner in the plan for a period not to exceed one year from the effective date of this interpretation.

In April 2006, the Professional Ethics Executive Committee (PEEC) of the AICPA issued the Conceptual Framework for AICPA Independence Standards (Conceptual Framework) [ET section 100.01], which describes the risk-based approach to analyzing independence matters that is used by PEEC when it develops independence standards. Consequently, this interpretation has been revised in the “Other Considerations” section to reflect the issuance of the Conceptual Framework. Because the Conceptual Framework [ET section 100.01] is effective April 30, 2007, with earlier application encouraged, the revisions made in the “Other Considerations” section of this interpretation are also effective April 30, 2007, with earlier application encouraged.

ET Section 101

Independence

.01

Rule 101—Independence. A member in public practice shall be independent in the performance of professional services as required by standards promulgated by bodies designated by Council.
Interpretations under Rule 101

—Independence

In performing an attest engagement, a member should consult the rules of his or her state board of accountancy, his or her state CPA society, the Public Company Accounting Oversight Board and the U.S. Securities and Exchange Commission (SEC) if the member's report will be filed with the SEC, the U.S. Department of Labor (DOL) if the member's report will be filed with the DOL, the Government Accountability Office (GAO) if law, regulation, agreement, policy or contract requires the member's report to be filed under GAO regulations, and any organization that issues or enforces standards of independence that would apply to the member's engagement. Such organizations may have independence requirements or rulings that differ from (e.g., may be more restrictive than) those of the AICPA.

.02

101-1—Interpretation of Rule 101. Independence shall be considered to be impaired if:

A. During the period of the professional engagement a covered member

1. Had or was committed to acquire any direct or material indirect financial interest in the client.

2. Was a trustee of any trust or executor or administrator of any estate if such trust or estate had or was committed to acquire any direct or material indirect financial interest in the client and

(i) The covered member (individually or with others) had the authority to make investment decisions for the trust or estate; or

(ii) The trust or estate owned or was committed to acquire more than 10 percent of the client's outstanding equity securities or other ownership interests; or

(iii) The value of the trust's or estate's holdings in the client exceeded 10 percent of the total assets of the trust or estate.

3. Had a joint closely held investment that was material to the covered member.

4. Except as specifically permitted in interpretation 101-5, had any loan to or from the client, any officer or director of the client, or any individual owning 10 percent or more of the client's outstanding equity securities or other ownership interests.

B. During the period of the professional engagement, a partner or professional employee of the firm, his or her immediate family, or any group of such persons acting together owned more than 5 percent of a client's outstanding equity securities or other ownership interests.

C. During the period covered by the financial statements or during the period of the professional engagement, a firm, or partner or professional employee of the firm was simultaneously associated with the client as a(n) Director, officer, or employee, or in any capacity equivalent to that of a member of management;

2. Promoter, underwriter, or voting trustee; or

3. Trustee for any pension or profit-sharing trust of the client.
Transition Period for Certain Business and Employment Relationships
A business or employment relationship with a client that impairs independence under interpretation 101-1.C [ET section 101.02], and that existed as of November 2001, will not be deemed to impair independence provided such relationship was permitted under rule 101 [ET section 101.01], and its interpretations and rulings as of November 2001, and the individual severed that relationship on or before May 31, 2002.

Application of the Independence Rules to Covered Members Formerly Employed by a Client or Otherwise Associated With a Client
An individual who was formerly (i) employed by a client or (ii) associated with a client as a(n) officer, director, promoter, underwriter, voting trustee, or trustee for a pension or profit-sharing trust of the client would impair his or her firm’s independence if the individual—

1. Participated on the attest engagement team or was an individual in a position to influence the attest engagement for the client when the attest engagement covers any period that includes his or her former employment or association with that client; or
2. Was otherwise a covered member with respect to the client unless the individual first dissociates from the client by—
   (a) Terminating any relationships with the client described in interpretation 101-1.C [ET section 101.02];
   (b) Disposing of any direct or material indirect financial interest in the client;
   (c) Collecting or repaying any loans to or from the client, except for loans specifically permitted or grandfathered under interpretation 101-5 [ET section 101.07];
   (d) Ceasing to participate fn 1 in all employee benefit plans sponsored by the client, unless the client is legally required to allow the individual to participate in the plan (for example, COBRA) and the individual pays 100 percent of the cost of participation on a current basis; and
   (e) Liquidating or transferring all vested benefits in the client’s defined benefit plans, defined contribution plans, deferred compensation plans, and other similar arrangements at the earliest date permitted under the plan. However, liquidation or transfer is not required if a penalty fn 2 significant to the benefits is imposed upon liquidation or transfer.

Application of the Independence Rules to a Covered Member’s Immediate Family
Except as stated in the following paragraph, a covered member’s immediate family is subject to rule 101 [ET section 101.01], and its interpretations and rulings.
The exceptions are that independence would not be considered to be impaired solely as a result of the following:

1. An individual in a covered member’s immediate family was employed by the client in a position other than a key position.
2. In connection with his or her employment, an individual in the immediate family of one of the following covered members participated in a retirement, savings, compensation, or similar plan that is a client, is sponsored by a client, or that invests in a client (provided such plan is normally offered to all employees in similar positions):
   a. A partner or manager who provides ten or more hours of non-attest services to the client; or
   b. Any partner in the office in which the lead attest engagement partner primarily practices in connection with the attest engagement.

For purposes of determining materiality under rule 101 [ET section 101.01] the financial interests of the covered member and his or her immediate family should be aggregated.

Application of the Independence Rules to Close Relatives
Independence would be considered to be impaired if—
1. An individual participating on the attest engagement team has a close relative who had
   a. A key position with the client, or
   b. A financial interest in the client that
      (i) Was material to the close relative and of which the individual has knowledge; or
      (ii) Enabled the close relative to exercise significant influence over the client.

2. An individual in a position to influence the attest engagement or any partner in the office in which the
   lead attest engagement partner primarily practices in connection with the attest engagement has a close
   relative who had
   a. A key position with the client; or
   b. A financial interest in the client that
      (i) Was material to the close relative and of which the individual or partner has knowledge; and
      (ii) Enabled the close relative to exercise significant influence over the client.

**Grandfathered Employment Relationships**

Employment relationships of a covered member’s immediate family and close relatives with an existing
attest client that impair independence under this interpretation and that existed as of November 2001, will
not be deemed to impair independence provided such relationships were permitted under preexisting
requirements of rule 101 [ET section 101.01], and its interpretations and rulings.

**Transition Period for Other Considerations**

The provisions of the Conceptual Framework for AICPA Independence Standards [see ET section 100.01]
and the related revision to “Other Considerations” of Interpretation No. 101-1 are effective for all
independence decisions made as of April 30, 2007. Earlier application is encouraged.

**Other Considerations**

It is impossible to enumerate all circumstances in which the appearance of independence might be
questioned. In the absence of an independence interpretation or ruling under Rule 101 [see ET section
101.01] that addresses a particular circumstance, a members should evaluate whether that circumstance
would lead a reasonable person aware of all the relevant facts to conclude that there is an unacceptable
threat to the member’s and the firm’s independence. When making that evaluation, members should refer to
the risk-based approach described in the Conceptual Framework for AICPA Independence Standards [see
ET section 100.01]. If the threats to independence are not at an acceptable level, safeguards should be
applied to eliminate the threats or reduce them to an acceptable level. In cases where threats to
independence are not at an acceptable level, thereby requiring the application of safeguards, the threats
identified and the safeguards applied to eliminate the threats or reduce them to an acceptable level should
be documented.

June 30, 1990, by the Professional Ethics Executive Committee. Revised, November 1991, effective
January 1, 1992, with earlier application encouraged, by the Professional Ethics Executive Committee.
Revised, effective February 28, 1998, by the Professional Ethics Executive Committee. Revised, November
2001, effective May 31, 2002, with earlier application encouraged, by the Professional Ethics Executive
Committee. Revised, effective July 31, 2002, by the Professional Ethics Executive Committee. Revised,
effective March 31, 2003, by the Professional Ethics Executive Committee. Revised, effective April 30, 2003,
The following Ethics Interpretation No. 101-2 reflects revisions made to the AICPA Code of Professional Conduct after April 16, 2003. As such, the following Ethics Interpretation No. 101-2 is not part of the standards adopted or established by the Public Company Accounting Oversight Board.

101-2—Employment or association with attest clients. A firm's independence will be considered to be impaired with respect to a client if a partner or professional employee leaves the firm and is subsequently employed by or associated with that client in a key position unless all the following conditions are met:

1. Amounts due to the former partner or professional employee for his or her previous interest in the firm and for unfunded, vested retirement benefits are not material to the firm, and the underlying formula used to calculate the payments remains fixed during the payout period. Retirement benefits may also be adjusted for inflation and interest may be paid on amounts due.

2. The former partner or professional employee is not in a position to influence the accounting firm's operations or financial policies.

3. The former partner or professional employee does not participate or appear to participate in, and is not associated with the firm, whether or not compensated for such participation or association, once employment or association with the client begins. An appearance of participation or association results from such actions as:

   • The individual provides consultation to the firm.
   • The firm provides the individual with an office and related amenities (for example, secretarial and telephone services).
   • The individual's name is included in the firm's office directory.
   • The individual's name is included as a member of the firm in other membership lists of business, professional, or civic organizations, unless the individual is clearly designated as retired.

4. The ongoing attest engagement team considers the appropriateness or necessity of modifying the engagement procedures to adjust for the risk that, by virtue of the former partner or professional employee's prior knowledge of the audit plan, audit effectiveness could be reduced.

5. The firm assesses whether existing attest engagement team members have the appropriate experience and stature to effectively deal with the former partner or professional employee and his or her work, when that person will have significant interaction with the attest engagement team.

6. The subsequent attest engagement is reviewed to determine whether the engagement team members maintained the appropriate level of skepticism when evaluating the representations and work of the former partner or professional employee, when the person joins the client in a key position within one year of disassociating from the firm and has significant interaction with the attest engagement team. The review should be performed by a professional with appropriate stature, expertise, and objectivity and should be tailored based on the position that the person assumed at the client, the position he or she held at the firm, the nature of the services he or she provided to the client, and other relevant facts and circumstances. Appropriate actions, as deemed necessary, should be taken based on the results of the review.

Responsible members within the firm should implement procedures for compliance with the preceding conditions when firm professionals are employed or associated with attest clients.
With respect to conditions 4, 5, and 6, the procedures adopted will depend on several factors, including whether the former partner or professional employee served as a member of the engagement team, the positions he or she held at the firm and has accepted at the client, the length of time that has elapsed since the professional left the firm, and the circumstances of his or her departure. fn3

**Considering Employment or Association With the Client**

When a member of the attest engagement team or an individual in a position to influence the attest engagement intends to seek or discuss potential employment or association with an attest client, or is in receipt of a specific offer of employment from an attest client, independence will be impaired with respect to the client unless the person promptly reports such consideration or offer to an appropriate person in the firm, and removes himself or herself from the engagement until the employment offer is rejected or employment is no longer being sought. When a covered member becomes aware that a member of the attest engagement team or an individual in a position to influence the attest engagement is considering employment or association with a client, the covered member should notify an appropriate person in the firm. The appropriate person should consider what additional procedures may be necessary to provide reasonable assurance that any work performed for the client by that person was performed with objectivity and integrity as required under rule 102 [ET section 102.01]. Additional procedures, such as reperformance of work already done, will depend on the nature of the engagement and the individual involved. [Replaces previous interpretation 101-2, Retired Partners and Firm Independence, August, 1989, effective August 31, 1989. Revised, effective December 31, 1998, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Revised, effective April 30, 2003, by the Professional Ethics Executive Committee.]

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The following Ethics Interpretation No. 101-3 reflects revisions made to the AICPA Code of Professional Conduct after April 16, 2003. As such, the following Ethics Interpretation No. 101-3 is not part of the standards adopted or established by the Public Company Accounting Oversight Board.

**101-3—Performance of nonattest services.** Before a member or his or her firm (“member”) performs nonattest services (for example, tax or consulting services) for an attest client, the member should determine that the requirements described in this interpretation have been met. In cases where the requirements have not been met during the period of the professional engagement or the period covered by the financial statements, the member’s independence would be impaired.

**Engagements Subject to Independence Rules of Certain Regulatory Bodies**

This interpretation requires compliance with independence regulations of authoritative regulatory bodies (such as the Securities and Exchange Commission [SEC], the General Accounting Office [GAO], the Department of Labor [DOL], and state boards of accountancy) where a member performs nonattest services for an attest client and is required to be independent of the client under the regulations of the applicable regulatory body. Accordingly, failure to comply with the nonattest services provisions contained in the independence rules of the applicable regulatory body that are more restrictive than the provisions of this interpretation would constitute a violation of this interpretation.

**General Requirements for Performing Nonattest Services**

1. The member should not perform management functions or make management decisions for the attest client. However, the member may provide advice, research materials, and recommendations to assist the client’s management in performing its functions and making decisions.

2. The client must agree to perform the following functions in connection with the engagement to perform nonattest services:

   a. Make all management decisions and perform all management functions;
   b. Designate an individual who possesses suitable skill, knowledge, and/or experience, preferably within senior management, to oversee the services;
   c. Evaluate the adequacy and results of the services performed;
   d. Accept responsibility for the results of the services; and
   e. Establish and maintain internal controls, including monitoring ongoing activities.
The member should be satisfied that the client will be able to meet all of these criteria and make an informed judgment on the results of the member's nonattest services. In assessing whether the designated individual possesses suitable skill, knowledge, and/or experience, the member should be satisfied that such individual understands the services to be performed sufficiently to oversee them. However, the individual is not required to possess the expertise to perform or re-perform the services.

In cases where the client is unable or unwilling to assume these responsibilities (for example, the client does not have an individual with suitable skill, knowledge, and/or experience to oversee the nonattest services provided, or is unwilling to perform such functions due to lack of time or desire), the member’s provision of these services would impair independence.

3. Before performing nonattest services, the member should establish and document in writing his or her understanding with the client (board of directors, audit committee, or management, as appropriate in the circumstances) regarding the following:

a. Objectives of the engagement
b. Services to be performed
c. Client's acceptance of its responsibilities
d. Member's responsibilities
e. Any limitations of the engagement

The documentation requirement does not apply to:

f. Nonattest services performed prior to January 1, 2005.
g. Nonattest services performed prior to the client becoming an attest client.

General requirements 2 and 3 above do not apply to certain routine activities performed by the member such as providing advice and responding to the client's questions as part of the normal client-member relationship.

General Activities

The following are some general activities that would impair a member’s independence:

- Authorizing, executing or consummating a transaction, or otherwise exercising authority on behalf of a client or having the authority to do so
- Preparing source documents, evidencing the occurrence of a transaction
- Having custody of client assets
- Supervising client employees in the performance of their normal recurring activities
- Determining which recommendations of the member should be implemented
- Reporting to the board of directors on behalf of management
- Serving as a client’s stock transfer or escrow agent, registrar, general counsel or its equivalent

Specific Examples of Nonattest Services

The examples in the following table identify the effect that performance of certain nonattest services for an attest client can have on a member’s independence. These examples presume that the general requirements in the previous section “General Requirements for Performing Nonattest Services” have been met and are not intended to be all-inclusive of the types of nonattest services performed by members.
**Bookkeeping**

- Record transactions for which management has determined or approved the appropriate account classification, or post coded transactions to a client’s general ledger.
- Prepare financial statements based on information in the trial balance.
- Post client-approved entries to a client’s trial balance.
- Propose standard, adjusting, or correcting journal entries or other changes affecting the financial statements to the client provided the client reviews the entries and the member is satisfied that management understands the nature of the proposed entries and the impact the entries have on the financial statements.
- Determine or change journal entries, account codings or classification for transactions, or other accounting records without obtaining client approval.
- Authorize or approve transactions.
- Prepare source documents.
- Make changes to source documents without client approval.

**Payroll and other disbursement**

- Using payroll time records provided and approved by the client, generate unsigned checks, or process client’s payroll.
- Transmit client-approved payroll or other disbursement information to a financial institution provided the client has authorized the member to make the transmission and has made arrangements for the financial institution to limit the corresponding individual payments as to amount and payee. In addition, once transmitted, the client must authorize the financial institution to process the information.
- Make electronic payroll tax payments in accordance with U.S. Treasury Department or comparable guidelines provided the client has made arrangements for its financial institution to limit such payments to a named payee.
- Accept responsibility to authorize payment of client funds, electronically or otherwise, except as specifically provided for with respect to electronic payroll tax payments.
- Accept responsibility to sign or cosign client checks, even if only in emergency situations.
- Maintain a client’s bank account or otherwise have custody of a client’s funds or make credit or banking decisions for the client.
- Sign payroll tax return on behalf of client management.
- Approve vendor invoices for payment

**Benefit plan administration**

- Communicate summary plan data to plan trustee.
- Advise client management regarding the application or impact of provisions of the plan document.
- Process transactions (e.g., investment/benefit elections or increase/decrease contributions to the plan; data entry; participant confirmations; and processing of distributions and loans) initiated by plan participants through the member’s electronic medium, such as an interactive voice response system or Internet connection or other media.
- Prepare account valuations for plan participants using data collected.
- Make policy decisions on behalf of client management.
- When dealing with plan participants, interpret the plan document on behalf of management without first obtaining management’s concurrence.
- Make disbursements on behalf of the plan.
- Have custody of assets of a plan.
- Serve a plan as a fiduciary as defined by ERISA.
• Through the member’s electronic or other media.

• Prepare and transmit participant statements to plan participants based on data collected through the member’s electronic or other medium.

• Make investment decisions on behalf of client management or otherwise have discretionary authority over a client’s investments.

• Recommend the allocation of funds that a client should invest in various asset classes, depending upon the client’s desired rate of return, risk tolerance, etc.

• Perform recordkeeping and reporting of client’s portfolio balances including providing a comparative analysis of the client’s investments to third-party benchmarks.

• Execute a transaction to buy or sell a client’s investment.

• Review the manner in which a client’s portfolio is being managed by investment account managers, including determining whether the managers are (1) following the guidelines of the client’s investment policy statement; (2) meeting the client’s investment objectives; and (3) conforming to the client’s stated investment styles.

• Transmit a client’s investment selection to a broker-dealer or equivalent provided the client has authorized the broker-dealer or equivalent to execute the transaction.

• Have custody of client assets, such as taking temporary possession of securities purchased by a client.

• Assist in developing corporate strategies.

• Assist in identifying or introducing the client to possible sources of capital that meet the client’s specifications or criteria.

• Assist in analyzing the effects of proposed transactions including providing advice to a client during negotiations with potential buyers, sellers, or capital sources.

• Commit the client to the terms of a transaction or consummate a transaction on behalf of the client.

• Assist in drafting an offering document or memorandum.

• Participate in transaction negotiations in an advisory capacity.

• Act as a promoter, underwriter, broker-dealer, or guarantor of client securities, or distributor of private placement memoranda or offering documents.

• Be named as a financial adviser in a client's private placement memorandum or offering documents.

• Maintain custody of client securities.

• Recommend a position description or candidate specifications.

• Solicit and perform screening of candidates and recommend qualified candidates to a client based on the client-approved criteria (e.g., required

• Commit the client to employee compensation or benefit arrangements.

• Hire or terminate client employees.
Business risk consulting

- Provide assistance in assessing the client's business risks and control processes.
- Recommend a plan for making improvements to a client’s control processes and assist in implementing these improvements.
- Make or approve business risk decisions.
- Present business risk considerations to the board or others on behalf of management.

Information systems—design, installation or integration

- Install or integrate a client’s financial information system, that was not designed or developed by the member (e.g., an off-the-shelf accounting package).
- Design or develop a client’s financial information system.
- Assist in setting up the client’s chart of accounts and financial statement format with respect to the client’s financial information system.
- Design, develop, install, or integrate a client’s information system that is unrelated to the client’s financial statements or accounting records.
- Make other than insignificant modifications to source code underlying a client's existing financial information system.
- Supervise client personnel in the daily operation of a client’s information system.
- Provide training and instruction to client employees on an information and control system.
- Operate a client’s local area network (LAN) system.

Appraisal, Valuation, and Actuarial Services

Independence would be impaired if a member performs an appraisal, valuation, or actuarial service for an attest client where the results of the service, individually or in the aggregate, would be material to the financial statements and the appraisal, valuation, or actuarial service involves a significant degree of subjectivity.

Valuations performed in connection with, for example, employee stock ownership plans, business combinations, or appraisals of assets or liabilities generally involve a significant degree of subjectivity. Accordingly, if these services produce results that are material to the financial statements, independence would be impaired.

An actuarial valuation of a client's pension or postemployment benefit liabilities generally produces reasonably consistent results because the valuation does not require a significant degree of subjectivity. Therefore, such services would not impair independence. In addition, appraisal, valuation, and actuarial services performed for nonfinancial statement purposes would not impair independence. However, in performing such services, all other requirements of this interpretation should be met, including that all significant assumptions and matters of judgment are determined or approved by the client and the client is in a position to have an informed judgment on, and accepts responsibility for, the results of the service.

Internal Audit Assistance Services

Internal audit services involve assisting the client in the performance of its internal audit activities, sometimes referred to as “internal audit outsourcing.” In evaluating whether independence would be impaired with respect to an attest client, the nature of the service needs to be considered.

Assisting the client in performing financial and operational internal audit activities would impair independence unless the member takes appropriate steps to ensure that the client understands its responsibility for establishing and maintaining the internal control system and directing the internal audit.
function, including the management thereof. Accordingly, any outsourcing of the internal audit function to the member whereby the member in effect manages the internal audit activities of the client would impair independence.

In addition to the general requirements of this interpretation, the member should ensure that client management:

- Designates an individual or individuals, who possess suitable skill, knowledge, and/or experience, preferably within senior management, to be responsible for the internal audit function;
- Determines the scope, risk, and frequency of internal audit activities, including those to be performed by the member providing internal audit assistance services;
- Evaluates the findings and results arising from the internal audit activities, including those performed by the member providing internal audit assistance services; and
- Evaluates the adequacy of the audit procedures performed and the findings resulting from the performance of those procedures by, among other things, obtaining reports from the member.

The member should also be satisfied that the client’s board of directors, audit committee, or other governing body is informed about the member’s and management’s respective roles and responsibilities in connection with the engagement. Such information should provide the client’s governing body a basis for developing guidelines for management and the member to follow in carrying out these responsibilities and monitoring how well the respective responsibilities have been met.

The member is responsible for performing the internal audit procedures in accordance with the terms of the engagement and reporting thereon. The performance of such procedures should be directed, reviewed, and supervised by the member. The report should include information that allows the individual responsible for the internal audit function to evaluate the adequacy of the audit procedures performed and the findings resulting from the performance of those procedures. This report may include recommendations for improvements in systems, processes, and procedures. The member may assist the individual responsible for the internal audit function in performing preliminary audit risk assessments, preparing audit plans, and recommending audit priorities. However, the member should not undertake any responsibilities that are required, as described above, to be performed by the individual responsible for the internal audit function.

The following are examples of activities (in addition to those listed in the “General Activities” section of this interpretation) that, if performed as part of an internal audit assistance engagement, would impair independence:

- Performing ongoing monitoring activities or control activities (for example, reviewing loan originations as part of the client’s approval process or reviewing customer credit information as part of the customer’s sales authorization process) that affect the execution of transactions or ensure that transactions are properly executed, accounted for, or both, and performing routine activities in connection with the client’s operating or production processes that are equivalent to those of an ongoing compliance or quality control function
- Determining which, if any, recommendations for improving the internal control system should be implemented
- Reporting to the board of directors or audit committee on behalf of management or the individual responsible for the internal audit function
- Approving or being responsible for the overall internal audit work plan including the determination of the internal audit risk and scope, project priorities, and frequency of performance of audit procedures
- Being connected with the client as an employee or in any capacity equivalent to a member of client management (for example, being listed as an employee in client directories or other client publications, permitting himself or herself to be referred to by title or description as supervising or being in charge of the client’s internal audit function, or using the client’s letterhead or internal correspondence forms in communications)

The foregoing list is not intended to be all-inclusive.
Services involving an extension of the procedures that are generally of the type considered to be extensions of the member's audit scope applied in the audit of the client's financial statements, such as confirming of accounts receivable and analyzing fluctuations in account balances, are not considered internal audit assistance services and would not impair independence even if the extent of such testing exceeds that required by generally accepted auditing standards. In addition, engagements performed under the attestation standards would not be considered internal audit assistance services and therefore would not impair independence.

Transition

Independence would not be impaired as a result of the more restrictive requirements of interpretation 101-3, provided the provision of any such nonattest services are pursuant to arrangements in existence on December 31, 2003, and are completed by December 31, 2004, and the member was in compliance with the preexisting requirements of this interpretation.


.06

101-4—Honorary directorships and trusteeships of not-for-profit organization. Partners or professional employees of a firm (individual) may be asked to lend the prestige of their names to not-for-profit organizations that limit their activities to those of a charitable, religious, civic, or similar nature by being named as a director or a trustee. An individual who permits his or her name to be used in this manner would not be considered to impair independence under rule 101 [ET section 101.01] provided his or her position is clearly honorary, and he or she cannot vote or otherwise participate in board or management functions. If the individual is named in letterheads and externally circulated materials, he or she must be identified as an honorary director or honorary trustee. [Formerly paragraph .05, renumbered by adoption of the Code of Professional Conduct on January 12, 1988. Formerly interpretation 101-1. Revised, effective June 30, 1990, by the Professional Ethics Executive Committee. Renumbered as interpretation 101-4 and moved from paragraph .03, April, 1992. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

.07

101-5—Loans from financial institution clients and related terminology. Interpretation 101-1.A.4 [ET section 101.02] provides that, except as permitted in this interpretation, independence shall be considered to be impaired if a covered member has any loan to or from a client, any officer or director of the client, or any individual owning ten percent or more of the client's outstanding equity securities or other ownership interests. This interpretation describes the conditions a covered member (or his or her immediate family ) must meet in order to apply an exception for a "Grandfathered Loan" or "Other Permitted Loan."

Grandfathered Loans

Unsecured loans that are not material to the covered member's net worth, home mortgages, and other secured loans are grandfathered if:

(1) they were obtained from a financial institution under that institution's normal lending procedures, terms, and requirements ,

(2) after becoming a covered member they are kept current as to all terms at all times and those terms do not change in any manner not provided for in the original loan agreement,
(3) they were:

a) obtained from the financial institution prior to its becoming a client requiring independence; or

b) obtained from a financial institution for which independence was not required and were later sold to a client for which independence is required; or

c) obtained prior to February 5, 2001 and met the requirements of previous provisions of Interpretation 101-5 [ET section 101.07] covering grandfathered loans; or

d) obtained between February 5, 2001 and May 31, 2002, and the covered member was in compliance with the applicable independence requirements of the SEC during that period; or

e) obtained after May 31, 2002 from a financial institution client requiring independence by a borrower prior to his or her becoming a covered member with respect to that client

In determining when a loan was obtained, the date a loan commitment or line of credit is granted must be used, rather than the date a transaction closes or funds are obtained.

For purposes of applying the grandfathered loans provision when the covered member is a partner in a partnership:

- a loan to a limited partnership (or similar type of entity) or a general partnership would be ascribed to each covered member who is a partner in the partnership on the basis of their legal liability as a limited or general partner if:
  - the covered member's interest in the limited partnership, either individually or combined with the interest of one or more covered members, exceeds 50 percent of the total limited partnership interest; or
  - the covered member, either individually or together with one or more covered members, can control the general partnership.

- even if no amount of a partnership loan is ascribed to the covered member(s) identified above, independence is considered to be impaired if the partnership renegotiates the loan or enters into a new loan that is not one of the permitted loans described below.

Other Permitted Loans
This interpretation permits only the following new loans and leases to be obtained from a financial institution client for which independence is required. These loans and leases must be obtained under the institution’s normal lending procedures, terms, and requirements and must, at all times, be kept current as to all terms.

1. Automobile loans and leases collateralized by the automobile.

2. Loans fully collateralized by the cash surrender value of an insurance policy.

3. Loans fully collateralized by cash deposits at the same financial institution (e.g., “passbook loans”).

4. Aggregate outstanding balances from credit cards and overdraft reserve accounts that are reduced to $10,000 or less on a current basis taking into consideration the payment due date and any available grace period.

Related prohibitions that may be more restrictive are prescribed by certain state and federal agencies having regulatory authority over such financial institutions. Broker-dealers, for example, are subject to regulation by the Securities and Exchange Commission.


.08

101-6—The effect of actual or threatened litigation on independence. In some circumstances, independence may be considered to be impaired as a result of litigation or the expressed intention to commence litigation as discussed below.

Litigation between client and member
The relationship between the management of the client and a covered member must be characterized by complete candor and full disclosure regarding all aspects of the client’s business operations. In addition, there must be an absence of bias on the part of the covered member so that he or she can exercise professional judgment on the financial reporting decisions made by the management. When the present management of a client company commences, or expresses an intention to commence, legal action against a covered member, the covered member and the client's management may be placed in adversarial positions in which the management’s willingness to make complete disclosures and the covered member’s objectivity may be affected by self-interest.

For the reasons outlined above, independence may be impaired whenever the covered member and the covered member’s client or its management are in threatened or actual positions of material adverse interests by reason of threatened or actual litigation. Because of the complexity and diversity of the situations of adverse interests which may arise, however, it is difficult to prescribe precise points at which independence may be impaired. The following criteria are offered as guidelines:

1. The commencement of litigation by the present management alleging deficiencies in audit work for the client would be considered to impair independence.

2. The commencement of litigation by the covered member against the present management alleging management fraud or deceit would be considered to impair independence.

3. An expressed intention by the present management to commence litigation against the covered member alleging deficiencies in audit work for the client would be considered to impair independence if the auditor concludes that it is probable that such a claim will be filed.

4. Litigation not related to performance of an attest engagement for the client (whether threatened or actual) for an amount not material to the covered member’s firm or to the client company would not generally be considered to affect the relationship in such a way as to impair independence. Such claims may arise, for example, out of disputes as to billings for services, results of tax or management services advice or similar matters.

Litigation by security holders
A covered member may also become involved in litigation (“primary litigation”) in which the covered member and the client or its management are defendants. Such litigation may arise, for example, when one or more stockholders bring a stockholders’ derivative action or a so-called “class action” against the client or its management, its officers, directors, underwriters and covered members under the securities laws. Such primary litigation in itself would not alter fundamental relationships between the client or its management and the covered member and therefore would not be deemed to have an adverse impact on independence.

These situations should be examined carefully, however, since the potential for adverse interests may exist if cross-claims are filed against the covered member alleging that the covered member is responsible for any deficiencies or if the covered member alleges fraud or deceit by the present management as a defense. In assessing the extent to which independence may be impaired under these conditions, the covered member should consider the following additional guidelines:

1. The existence of cross-claims filed by the client, its management, or any of its directors to protect a right to legal redress in the event of a future adverse decision in the primary litigation (or, in lieu of cross-claims,
agreements to extend the statute of limitations) would not normally affect the relationship between client management and the covered member in such a way as to impair independence, unless there exists a significant risk that the cross-claim will result in a settlement or judgment in an amount material to the covered member's firm or to the client.

2. The assertion of cross-claims against the covered member by underwriters would not generally impair independence if no such claims are asserted by the client or the present management.

3. If any of the persons who file cross-claims against the covered member are also officers or directors of other clients of the covered member, independence with respect to such other clients would not generally be considered to be impaired.

Other third-party litigation
Another type of third-party litigation against the covered member may be commenced by a lending institution, other creditor, security holder, or insurance company who alleges reliance on financial statements of the client with which the covered member is associated as a basis for extending credit or insurance coverage to the client. In some instances, an insurance company may commence litigation (under subrogation rights) against the covered member in the name of the client to recover losses reimbursed to the client. These types of litigation would not normally affect independence with respect to a client who is either not the plaintiff or is only the nominal plaintiff, since the relationship between the covered member and client management would not be affected. They should be examined carefully, however, since the potential for adverse interests may exist if the covered member alleges, in his defense, fraud, or deceit by the present management.

If the real party in interest in the litigation (e.g., the insurance company) is also a client of the covered member (“the plaintiff client”), independence with respect to the plaintiff client may be impaired if the litigation involves a significant risk of a settlement or judgment in an amount which would be material to the covered member's firm or to the plaintiff client.

Effects of impairment of independence
If the covered member believes that the circumstances would lead a reasonable person having knowledge of the facts to conclude that the actual or intended litigation poses an unacceptable threat to independence, the covered member should either (a) disengage himself or herself, or (b) disclaim an opinion because of lack of independence. Such disengagement may take the form of resignation or cessation of any attest engagement then in progress pending resolution of the issue between the parties.

Termination of impairment
The conditions giving rise to a lack of independence are generally eliminated when a final resolution is reached and the matters at issue no longer affect the relationship between the covered member and client. The covered member should carefully review the conditions of such resolution to determine that all impairments to the covered member’s objectivity have been removed.

[Formerly paragraph .07, renumbered by adoption of the Code of Professional Conduct on January 12, 1988. Revised, effective June 30, 1990, by the Professional Ethics Executive Committee. Revised, effective September 30, 1995, by the Professional Ethics Executive Committee, by deletion of subhead and paragraph and reissuance as ethics ruling No. 100, Actions Permitted When Independence is Impaired, under rule 101. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

[.09]

[101-7]—[Deleted] [Formerly paragraph .08, renumbered by adoption of the Code of Professional Conduct on January 12, 1988.]

.10

101-8—Effect on independence of financial interests in nonclients having investor or investee relationships with a covered member's client.
Financial interests in nonclients that are related in various ways to a client may impair independence. Situations in which the nonclient investor is a partnership are covered in other rulings [ET section 191.138–139, 158–159, and 162–163].

**Terminology**

The following specifically identified terms are used in this interpretation as indicated:

1. **Client.** The term client means the person or entity with whose financial statements a covered member is associated.

2. **Significant Influence.** The term significant influence is as defined in Accounting Principles Board (APB) Opinion 18 [AC 182].

3. **Investor.** The term investor means (a) a parent, (b) a general partner, or (c) a natural person or corporation that has the ability to exercise significant influence.

4. **Investee.** The term investee means (a) a subsidiary or (b) an entity over which an investor has the ability to exercise significant influence.

**Interpretation**

Where a nonclient investee is material to a client investor, any direct or material indirect financial interest of a covered member in the nonclient investee would be considered to impair independence with respect to the client investor. If the nonclient investee is immaterial to the client investor, a covered member's material investment in the nonclient investee would cause an impairment of independence.
Where a client investee is material to nonclient investor, any direct or material indirect financial interest of a covered member in the nonclient investor would be considered to impair independence with respect to the client investee. If the client investee is immaterial to the nonclient investor, and if a covered member’s financial interest in the nonclient investor allows the covered member to exercise significant influence over the actions of the nonclient investor, independence would be considered to be impaired.

**Diagram:**

```
No

Is nonclient material to client?

No

Independence impaired if:
Covered member's investment in nonclient is material.

Client="Investor"
Nonclient="Investee"

Yes

Independence impaired if:

a. Covered member has direct financial interest in nonclient; or

b. Covered member has material indirect financial interest in nonclient.
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Other relationships, such as those involving brother-sister common control or client-nonclient joint ventures, may affect the appearance of independence. The covered member should make a reasonable inquiry to determine whether such relationships exist, and if they do, careful consideration should be given to whether the financial interests in question would lead a reasonable observer to conclude that the specified relationships pose an unacceptable threat to independence.

In general, in brother-sister common control situations, an immaterial financial interest of a covered member in the nonclient investee would not impair independence with respect to the client investee, provided the covered member could not exercise significant influence over the nonclient investor. However, if a covered member's financial interest in a nonclient investee is material, the covered member could be influenced by the nonclient investor, thereby impairing independence with respect to the client investee. In like manner, in a joint venture situation, an immaterial financial interest of a covered member in the nonclient investor would not impair the independence of the covered member with respect to the client investor, provided that the covered member could not exercise significant influence over the nonclient investor.

If a covered member does not and could not reasonably be expected to have knowledge of the financial interests or relationship described in this interpretation, independence would not be considered to be impaired under this interpretation.

101-10—The effect on independence of relationships with entities included in the governmental financial statements. For purposes of this Interpretation, a financial reporting entity's basic financial statements, issued in conformity with generally accepted accounting principles in the United States of America, include the government-wide financial statements (consisting of the entity's governmental activities, business-type activities, and discretely presented component units), the fund financial statements (consisting of major funds, nonmajor governmental and enterprise funds, internal service funds, blended component units, and fiduciary funds) and other entities disclosed in the notes to the basic financial statements. Entities that should be disclosed in the notes to the basic financial statements include, but are not limited to, related organizations, joint ventures, jointly governed organizations, and component units of another government with characteristics of a joint venture or jointly governed organization.

Auditor of Financial Reporting Entity

A covered member issuing a report on the basic financial statements of the financial reporting entity must be independent of the financial reporting entity, as defined in paragraph 1 of this Interpretation. However, independence is not required with respect to any major or nonmajor fund, internal service fund, fiduciary fund, or component unit or other entities disclosed in the financial statements, where the primary auditor explicitly states reliance on other auditors reports thereon. In addition, independence is not required with respect to an entity disclosed in the notes to the basic financial statements, if the financial reporting entity is not financially accountable for the organization and the required disclosure does not include financial information. For example, a disclosure limited to the financial reporting entity's ability to appoint the governing board members would not require a member to be independent of that organization. However, the covered member and his or her immediate family should not hold a key position with a major fund, nonmajor fund, internal service fund, fiduciary fund, or component unit of the financial reporting entity or other entity that should be disclosed in the notes to the basic financial statements.

Auditor of a Major Fund, Nonmajor Fund, Internal Service Fund, Fiduciary Fund, or Component Unit of the Financial Reporting Entity or Other Entity That Should Be Disclosed in the Notes to the Basic Financial Statements

A covered member who is auditing the financial statements of a major fund, nonmajor fund, internal service fund, fiduciary fund, or component unit of the financial reporting entity or an entity that should be disclosed in the notes to the basic financial statements of the financial reporting entity, but is not auditing the primary government, should be independent with respect to those financial statements that the covered member is reporting upon. The covered member is not required to be independent of the primary government or other funds or component units of the reporting entity or entities that should be disclosed in the notes to the basic financial statements. However, the covered member and his or her immediate family should not hold a key position within the primary government. For purposes of this Interpretation, a covered member and immediate family member would not be considered employed by the primary government if the exceptions provided for in ET section 92.03 are met. [For former paragraph .11, renumbered by adoption of the Code of Professional Conduct on January 12, 1988. References changed to reflect the issuance of the AICPA Code of Professional Conduct on January 12, 1988. Replaces previous interpretation 101-10. The Effect on Independence of Relationships Proscribed by Rule 101 and its Interpretations With Nonclient Entities Included With a Member's Client in the Financial Statements of a Governmental Reporting Entity, April 1991, effective April 30, 1991. Replaces previous interpretation 101-10, The Effect on Independence of Relationships With Entities Included in the Governmental Financial Statements, January 1996, effective January 31, 1996. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Revised, effective March 31, 2003, by the Professional Ethics Executive Committee.]

101-11—Modified application of rule 101 for certain engagements to issue restricted-use reports under the Statements on Standards for Attestation Engagements

Rule 101: Independence [ET section 101.01], and its interpretations and rulings apply to all attest engagements. However, for purposes of performing engagements to issue reports under the Statements on Standards for Attestation Engagements (SSAEs) that are restricted to identified parties, only the following
covered members, and their immediate families, are required to be independent with respect to the responsible party in accordance with rule 101 [ET section 101.01]:

Individuals participating on the attest engagement team;

- Individuals who directly supervise or manage the attest engagement partner; and
- Individuals who consult with the attest engagement team regarding technical or industry-related issues specific to the attest engagement.

In addition, independence would be considered to be impaired if the firm had a financial relationship covered by interpretation 101-1.A [ET section 101.02] with the responsible party that was material to the firm. In cases where the firm provides non-attest services to the responsible party that are prescribed under interpretation 101-3 [ET section 101.05] and that do not directly relate to the subject matter of the attest engagement, independence would not be considered to be impaired.

In circumstances where the individual or entity that engages the firm is not the responsible party or associated with the responsible party, individuals on the attest engagement team need not be independent of the individual or entity, but should consider their responsibilities under interpretation 102-2 [ET section 102.03] with regard to any relationships that may exist with the individual or entity that engages them to perform these services.

This interpretation does not apply to an engagement performed under the Statements on Auditing Standards or Statements on Standards for Accounting and Review Services, or to an examination or review engagement performed under the Statements on Standards for Attestation Engagements. [Replaces previous interpretation 101-11, Independence and Attest Engagements, January 1996, effective January 31, 1996. Revised, effective November 30, 2001, by the Professional Ethics Executive Committee.]

.14

101-12—Independence and cooperative arrangements with clients. Independence will be considered to be impaired if, during the period of a professional engagement, a member or his or her firm had any cooperative arrangement with the client that was material to the member's firm or to the client.

Cooperative Arrangement—A cooperative arrangement exists when a member's firm and a client jointly participate in a business activity. The following are examples, which are not all inclusive, of cooperative arrangements:

1. Prime/subcontractor arrangements to provide services or products to a third party
2. Joint ventures to develop or market products or services
3. Arrangements to combine one or more services or products of the firm with one or more services or products of the client and market the package with references to both parties
4. Distribution or marketing arrangements under which the firm acts as a distributor or marketer of the client's products or services, or the client acts as the distributor or marketer of the products or services of the firm

Nevertheless, joint participation with a client in a business activity does not ordinarily constitute a cooperative arrangement when all the following conditions are present:

a. The participation of the firm and the participation of the client are governed by separate agreements, arrangements, or understandings.

b. The firm assumes no responsibility for the activities or results of the client, and vice versa.

c. Neither party has the authority to act as the representative or agent of the other party.
In addition, the member's firm should consider the requirements of rule 302 [ET section 302.01] and rule 503 [ET section 503.01].

[Effective November 30, 1993. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

[.15]

The following Ethics Interpretation No. 101-13 reflects deletions made to the AICPA Code of Professional Conduct after April 16, 2003. As such, the following Ethics Interpretation No. 101-13 is not part of the standards adopted or established by the Public Company Accounting Oversight Board.

[101-13]—[Deleted]

.16

101-14 —The effect of alternative practice structures on the applicability of independence rules.

Because of changes in the manner in which members are structuring their practices, the AICPA's professional ethics executive committee (PEEC) studied various alternatives to "traditional structures" to determine whether additional independence requirements are necessary to ensure the protection of the public interest.

In many "nontraditional structures," a substantial (the nonattest) portion of a member's practice is conducted under public or private ownership, and the attest portion of the practice is conducted through a separate firm owned and controlled by the member. All such structures must comply with applicable laws, regulations, and Rule 505, Form of Organization and Name [ET section 505.01]. In complying with laws, regulations, and rule 505 [ET section 505.01], many elements of quality control are required to ensure that the public interest is adequately protected. For example, all services performed by members and persons over whom they have control must comply with standards promulgated by AICPA Council-designated bodies, and, for all other firms providing attest services, enrollment is required in an AICPA-approved practice-monitoring program. Finally, and importantly, the members are responsible, financially and otherwise, for all the attest work performed. Considering the extent of such measures, PEEC believes that the additional independence rules set forth in this interpretation are sufficient to ensure that attest services can be performed with objectivity and, therefore, the additional rules satisfactorily protect the public interest.

Rule 505 [ET section 505.01] and the following independence rules for an alternative practice structure (APS) are intended to be conceptual and applicable to all structures where the "traditional firm" engaged in attest services is closely aligned with another organization, public or private, that performs other professional services. The following paragraph and the chart below provide an example of a structure in use at the time this interpretation was developed. Many of the references in this interpretation are to the example. PEEC intends that the concepts expressed herein be applied, in spirit and in substance, to variations of the example structure as they develop.

The example APS in this interpretation is one where an existing CPA practice ("Oldfirm") is sold by its owners to another (possibly public) entity ("PublicCo"). PublicCo has subsidiaries or divisions such as a bank, insurance company or broker-dealer, and it also has one or more professional service subsidiaries or divisions that offer to clients nonattest professional services (e.g., tax, personal financial planning, and management consulting). The owners and employees of Oldfirm become employees of one of PublicCo's subsidiaries or divisions and may provide those nonattest services. In addition, the owners of Oldfirm form a new CPA firm ("Newfirm") to provide attest services. CPAs, including the former owners of Oldfirm, own a majority of Newfirm (as to vote and financial interests). Attest services are performed by Newfirm and are supervised by its owners. The arrangement between Newfirm and PublicCo (or one of its subsidiaries or divisions) includes the lease of employees, office space and equipment; the performance of back-office functions such as billing and collections; and advertising. Newfirm pays a negotiated amount for these services.

**APS Independence Rules for Covered Members**

The term covered member in an APS includes both employed and leased individuals. The firm in such definition would be Newfirm in the example APS. All covered members, including the firm, are subject to rule 101 [ET section 101.01] and its interpretations and rulings in their entirety. For example, no covered member may have, among other things, a direct financial interest in or a loan to or from an attest client of Newfirm.

**Partners** of one Newfirm generally would not be considered partners of another Newfirm except in situations where those partners perform services for the other Newfirm or where there are significant shared economic interests between partners of more than one Newfirm.
services in Newfirm 2, such owners would be considered to be partners of both Newfirms for purposes of applying the independence rules.

**APS Independence Rules for Persons and Entities Other Than Covered Members**

As stated above, the independence rules normally extend only to those persons and entities included in the definition of covered member. This normally would include only the “traditional firm” (Newfirm in the example APS), those covered members who own or are employed or leased by Newfirm, and entities controlled by one or more of such persons. Because of the close alignment in many APSs between persons and entities included in covered member and other persons and entities, to ensure the protection of the public interest, PEEC believes it appropriate to require restrictions in addition to those required in a traditional firm structure. Those restrictions are divided into two groups:

1. **Direct Superiors.** Direct Superiors are defined to include those persons so closely associated with a partner or manager who is a covered member, that such persons can directly control the activities of such partner or manager. For this purpose, a person who can directly control is the immediate superior of the partner or manager who has the power to direct the activities of that person so as to be able to directly or indirectly (e.g., through another entity over which the Direct Superior can exercise significant influence) derive a benefit from that person’s activities. Examples would be the person who has day-to-day responsibility for the activities of the partner or manager and is in a position to recommend promotions and compensation levels. This group of persons is, in the view of PEEC, so closely aligned through direct reporting relationships with such persons that their interests would seem to be inseparable. Consequently, persons considered Direct Superiors, and entities within the APS over which such persons can exercise significant influence are subject to rule 101 ([ET section 101.01](#)) and its interpretations and rulings in their entirety.

2. **Indirect Superiors and Other PublicCo Entities.** Indirect Superiors are those persons who are one or more levels above persons included in Direct Superior. Generally, this would start with persons in an organization structure to whom Direct Superiors report and go up the line from there. PEEC believes that certain restrictions must be placed on Indirect Superiors, but also believes that such persons are sufficiently removed from partners and managers who are covered persons to permit a somewhat less restrictive standard. Indirect Superiors are not connected with partners and managers who are covered members through direct reporting relationships; there always is a level in between. The PEEC also believes that, for purposes of the following, the definition of Indirect Superior also includes the immediate family of the Indirect Superior.

PEEC carefully considered the risk that an Indirect Superior, through a Direct Superior, might attempt to influence the decisions made during the engagement for a Newfirm attest client. PEEC believes that this risk is reduced to a sufficiently low level by prohibiting certain relationships between Indirect Superiors and Newfirm attest clients and by applying a materiality concept with respect to financial relationships. If the financial relationship is not material to the Indirect Superior, PEEC believes that he or she would not be sufficiently financially motivated to attempt such influence particularly with sufficient effort to overcome the presumed integrity, objectivity and strength of character of individuals involved in the engagement.

Similar standards also are appropriate for Other PublicCo Entities. These entities are defined to include PublicCo and all entities consolidated in the PublicCo financial statements that are not subject to rule 101 ([ET section 101.01](#)) and its interpretations and rulings in their entirety.

The rules for Indirect Superiors and Other PublicCo Entities are as follows:

**A.** Indirect Superiors and Other PublicCo Entities may not have a relationship contemplated by interpretation 101-1.A ([ET section 101.02](#)) (e.g., investments, loans, etc.) with an attest client of Newfirm that is material. In making the test for materiality for financial relationships of an Indirect Superior, all the financial relationships with an attest client held by such person should be aggregated and, to determine materiality, assessed in relation to the person’s net worth. In making the materiality test for financial relationships of Other PublicCo Entities, all the financial relationships with an attest client held by such entities should be aggregated and, to determine materiality, assessed in relation to the consolidated financial statements of PublicCo. In addition, any Other PublicCo Entity over which an Indirect Superior has direct responsibility cannot have a financial relationship with an attest client that is material in relation to the Other PublicCo Entity’s financial statements.

**B.** Further, financial relationships of Indirect Superiors or Other PublicCo Entities should not allow such persons or entities to exercise significant influence over the attest client. In making the test for significant influence, financial relationships of all Indirect Superiors and Other PublicCo Entities should be aggregated.

**C.** Neither Other PublicCo Entities nor any of their employees may be connected with an attest client of Newfirm as a promoter, underwriter, voting trustee, director or officer.
D. Except as noted in C above, Indirect Superiors and Other PublicCo Entities may provide services to an attest client of Newfirm that would impair independence if performed by Newfirm. For example, trustee and asset custodial services in the ordinary course of business by a bank subsidiary of PublicCo would be acceptable as long as the bank was not subject to rule 101 [ET section 101.01] and its interpretations and rulings in their entirety.

**Other Matters**

1. An example, using the chart below, of the application of the concept of Direct and Indirect Superiors would be as follows: The chief executive of the local office of the Professional Services Subsidiary (PSS), where the partners of Newfirm are employed, would be a Direct Superior. The chief executive of PSS itself would be an Indirect Superior, and there may be Indirect Superiors in between such as a regional chief executive of all PSS offices within a geographic area.

2. PEEC has concluded that Newfirm (and its partners and employees) may not perform an attest engagement for PublicCo or any of its subsidiaries or divisions.

3. PEEC has concluded that independence would be considered to be impaired with respect to an attest client of Newfirm if such attest client holds an investment in PublicCo that is material to the attest client or allows the attest client to exercise significant influence [fn 26] over PublicCo.

4. When making referrals of services between Newfirm and any of the entities within PublicCo, a member should consider the provisions of Interpretation 102-2, Conflicts of Interest [ET section 102.03].

**Alternative Practice Structure (APS) Model**

![Diagram](Image)

[Effective February 28, 1999; Revised, November 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

.17

101-15 – Financial relationships.

**Financial Interests**

Interpretation 101-1 [ET sec. 101.02A.1] states that independence shall be considered to be impaired if, during the period of the professional engagement, a covered member had or was committed to acquire any direct or material indirect financial interest in the client. When reviewing this interpretation, the covered
member should also refer to interpretation 101-1 [ET sec. 101.02] for the application of rule 101 and its interpretations and rulings to the covered member’s immediate family and close relatives.

This interpretation provides definitions of direct and indirect financial interests and further guidance on whether various types of financial interests should be considered to be direct or indirect financial interests and provides certain limited exceptions under which a covered member could hold a direct or material indirect financial interest in an attest client without being considered to have impaired his or her independence.

Definitions

A **financial interest** is an ownership interest in an equity or a debt security issued by an entity, including rights and obligations to acquire such an interest and derivatives directly related to such interest.

A **direct financial interest** is a financial interest:

1. Owned directly by an individual or entity (including those managed on a discretionary basis by others); or
2. Under the control of an individual or entity (including those managed on a discretionary basis by others); or
3. Beneficially owned through an investment vehicle, estate, trust, or other intermediary when the beneficiary:
   a. Controls the intermediary; or
   b. Has the authority to supervise or participate in the intermediary’s investment decisions.

An **indirect financial interest** is a financial interest beneficially owned through an investment vehicle, estate, trust, or other intermediary when the beneficiary neither controls the intermediary nor has the authority to supervise or participate in the intermediary’s investment decisions.

A financial interest is **beneficially owned** when an individual or entity is not the record owner of the interest but has a right to some or all of the underlying benefits of ownership. These benefits include the authority to direct the voting or the disposition of the interest or to receive the economic benefits of the ownership of the interest.

Unsolicited Financial Interests

Independence would not be considered to be impaired if an unsolicited financial interest in a client is received, such as through gift or inheritance, and the financial interest is disposed of as soon as practicable, but no later than 30 days after the covered member has knowledge of and the right to dispose of the financial interest. In addition, if the covered member becomes aware that he or she will receive or has received a material direct or material indirect financial interest in a client requiring independence but does not have the right to dispose of the financial interest, independence would be considered to be impaired unless the covered member does not participate on the attest engagement team and disposes of the financial interest as soon as practicable but no later than 30 days after the right to dispose exists.

Mutual Funds

The ownership of shares in a mutual fund is considered to be a direct financial interest in the mutual fund. The underlying investments of a mutual fund are considered to be indirect financial interests.

If the mutual fund is diversified, a covered member’s ownership of 5 percent or less of the outstanding shares of the mutual fund would not be considered to constitute a material indirect financial interest in the underlying investments.

If a covered member owns more than 5 percent of the outstanding shares of a diversified mutual fund, or if the mutual fund is not diversified, the covered member should evaluate the underlying investments of the mutual fund to determine whether the covered member holds a material indirect financial interest in any of the underlying investments.
For example, if a nondiversified mutual fund owns shares in attest client Company A, and

- The mutual fund’s net assets are $10,000,000;
- The covered member owns 1 percent of the outstanding shares of the mutual fund, having a value of $100,000; and
- The mutual fund has 10 percent of its assets invested in Company A;

the indirect financial interest of the covered member in Company A is $10,000 and this amount should be measured against the covered member’s net worth (including the net worth of his or her immediate family) to determine if it is material.

**Retirement, Savings, Compensation, or Similar Plans**

A covered member who participates in a retirement, savings, compensation, or similar plan is considered to have a direct financial interest in the plan.\(^\text{fn 29}\)

Investments held by a retirement, savings, compensation, or similar plan sponsored by a covered member’s firm would be considered direct financial interests of the firm.

If a covered member controls a retirement, savings, compensation, or similar plan or has the ability to supervise or participate in the plan’s investment decisions, the investments held by the plan would be considered direct financial interests of the covered member. Otherwise, the underlying plan investments would be considered indirect financial interests of the covered member.

Investments held in a defined benefit plan would not be considered financial interests of the covered member unless the covered member is a trustee of the plan or otherwise has the ability to supervise or participate in the plan’s investment decisions because the benefits are not dependent upon investment performance.

The following examples illustrate these concepts:

1. If a covered member is a trustee of a retirement, savings, compensation, or similar plan or otherwise has the authority to supervise or participate in the plan’s investment decisions, the underlying investments would be considered to be direct financial interests of the covered member.
2. If investments in a defined contribution plan are participant directed, whereby a covered member selects his or her underlying plan investments or selects from investment alternatives offered by the plan, the covered member would be considered to have a direct financial interest in those investments.
3. If investments in a defined contribution plan are not participant directed and the covered member has no authority to supervise or participate in the plan’s investment decisions, the covered member would be considered to have an indirect financial interest in the underlying plan investments.

Also refer to ethics ruling no. 107, Participation in Health and Welfare Plan Sponsored by Client \([\text{ET} \text{ sec.} \ 191.214-.215]\), and interpretation 101-1, Interpretation of Rule 101 \([\text{ET} \text{ sec.} \ 101.02]\), subsections “Application of the Independence Rules to Covered Members Formerly Employed by a Client or Otherwise Associated With a Client,” “Application of the Independence Rules to a Covered Member’s Immediate Family,” and “Application of the Independence Rules to Close Relatives.”

**Section 529 Plans\(^\text{fn 30}\)**

Section 529 plans are sponsored by states or higher education institutions, and may be prepaid tuition plans or savings plans. Both types of plans are established by an account owner for the benefit of a single beneficiary. The account owner may change the beneficiary at any time to another individual who is related to the previous beneficiary.

A covered member who is the account owner of a Section 529 prepaid tuition plan is considered to have a direct financial interest in the plan but not in the investments of the plan because the credits purchased
represent an obligation of the state or educational institution to provide the education regardless of the investment performance of the plan or the cost of the education at the future date.

A covered member who is the account owner of a Section 529 savings plan is considered to have a direct financial interest in both the plan and the investments of the plan because he or she decides in which sponsor’s Section 529 savings plan to invest and prior to making the investment has access to information about the plan’s investments.

If a covered member invests in a Section 529 savings plan that does not hold financial interests in an attest client at the time of the investment, but the plan subsequently invests in an attest client, the covered member should (1) transfer the account to another sponsor’s Section 529 savings plan or (2) transfer the account to another account owner who is not a covered member. However, when the transfer of the account will result in a penalty or tax that is significant to the account, the covered member may continue to own the account until the account can be transferred without significant penalty or tax, provided the covered member does not participate on the attest engagement team and is not in a position to influence the attest engagement.

A covered member who is a beneficiary of a Section 529 account is not considered to have a financial interest in the plan or the investments of the plan because he or she does not own the account or possess any of the underlying benefits of ownership and the beneficiary’s only interest is to receive distributions from the account for qualified higher education expenses if and when they are authorized by the account owner.

Before becoming engaged to perform an attest engagement for a government or governmental entity that sponsors a Section 529 plan, covered members that are account owners of a Section 529 plan should consider the guidance in interpretation 101-10, The Effect on Independence of Relationships With Entities Included in the Governmental Financial Statements [ET sec. 101.12].

**Trust Investments**

When a covered member is a grantor of a trust, the trust and the underlying investments held by the trust are considered to be direct financial interests if the covered member retains the right to amend or revoke the trust, or otherwise has the authority to control the trust or to supervise or participate in the trust’s investment decisions. However, where the covered member does not have the authority to amend or revoke the trust or to supervise or participate in the trust’s investment decisions, he or she is not considered to have a financial interest in the trust or the underlying investments held by the trust.

When a covered member is a beneficiary of a trust, the trust is considered to be a direct financial interest of the covered member and the underlying investments held by the trust are considered to be indirect financial interests of the covered member. However, if the covered member controls the trust or supervises or participates in the investment decisions of the trust, the underlying investments held by the trust are considered to be direct financial interests of the covered member.

In a blind trust, the grantor is also the beneficiary, but does not supervise or participate in the trust’s investment decisions during the term of the trust. However, the investments will ultimately revert to the grantor, and the grantor usually retains the right to amend or revoke the trust. Therefore, both the blind trust and the underlying investments held in a blind trust are considered to be direct financial interests of the covered member.

See interpretation 101-1 [ET sec. 101.02A.2] and ethics ruling no. 11 [ET sec. 191.021-.022] for additional guidance on trustee relationships.

**Partnerships**

The ownership of a general or limited partnership interest is considered a direct financial interest in the partnership.
The financial interests held by a partnership are considered to be direct financial interests of a covered member that is a general partner because the covered member is in a position to control the partnership or to supervise or participate in the partnership’s investment decisions.

The financial interests held by a limited partnership are considered to be indirect financial interests of a covered member who is a limited partner as long as the covered member does not control the partnership or supervise or participate in the partnership’s investment decisions. However, if the covered member has the ability to replace the general partner or has the authority to supervise or participate in the partnership’s investment decisions, the financial interests of the partnership would be considered to be direct financial interests of the covered member.

See interpretation 101-1 [ET sec. 101.02A.3] for additional guidance on joint closely held investments and interpretation 101-8 [ET sec. 101.10] for additional guidance on financial interests in nonclients having investor or investee relationships with a covered member.

Limited Liability Companies

The ownership of an interest in a limited liability company (LLC) is considered a direct financial interest in the LLC.

In an LLC, members who are managers control the LLC and have the authority to supervise or participate in the LLC’s investment decisions. Accordingly, if a covered member is a manager of the LLC, the financial interests of the LLC are considered to be direct financial interests of the covered member. If a covered member is a member but not a manager of the LLC, the covered member should look to the operating agreement of the LLC to determine whether he or she can control the LLC or has the authority to supervise or participate in the investment decisions of the LLC. If the covered member does not control the LLC, or have the authority to supervise or participate in the LLC’s investment decisions, the financial interests held by the LLC would be considered to be indirect financial interests of the covered member.

Insurance Products

An insurance policy obtained from a stock or mutual insurance company that does not offer the policy holder an investment option is not considered to be a financial interest. Accordingly, if a covered member owns an insurance policy issued by an attest client, independence is not considered to be impaired, provided the policy does not offer the policy holder an investment option and the policy was purchased under the insurance company’s normal terms, procedures, and requirements. If a mutual insurance company begins the demutualization process, covered members who hold an insurance policy from the company should refer to the guidance contained in the “Unsolicited Financial Interests” section of this Interpretation.

Some insurance policies offer an investment option whereby the policy owner may choose to invest part of the cash value in a variety of underlying investments. The underlying investments of this type of insurance policy are considered to be a financial interest, and the covered member should apply the guidance in this interpretation to determine whether the underlying investments are direct or indirect financial interests. For example, if the covered member has the ability to select the underlying investments or the authority to supervise or participate in the investment decisions and the cash value of the insurance policy is invested in a mutual fund, the mutual fund is considered to be a direct financial interest and the underlying investments of the mutual fund are considered to be indirect financial interests.

See interpretation 101-1 [ET sec. 101.02A.3] for additional guidance on joint closely held investments and interpretation 101-8 [ET sec. 101.10] for additional guidance on financial interests in nonclients having investor or investee relationships with a covered member.

Footnotes (ET Section 101 — Independence):
Terms shown in **boldface** type upon first usage in this interpretation are defined in **ET section 92, Definitions.** [Footnote added, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

This sentence reflects generally accepted auditing standards modified by the AICPA after April 16, 2003. As such, this sentence is not part of the standards adopted or established by the Public Company Accounting Oversight Board.

See Ethics Ruling No. 107, “Participation in Health and Welfare Plan of Client” [**ET section 191.214–215**], for instances in which participation was the result of permitted employment of the individual’s spouse or spousal equivalent.

A penalty includes an early withdrawal penalty levied under the tax law but excludes other income taxes that would be owed or market losses that may be incurred as a result of the liquidation or transfer.

A failure to prepare the required documentation would be considered a violation of Rule 202, Compliance With Standards (AICPA, Professional Standards, vol. 2, ET sec. 202.01), of the AICPA Code of Professional Conduct. Independence would not be considered to be impaired provided the member can demonstrate that he or she did apply safeguards to eliminate unacceptable threats or reduce them to an acceptable level.

A failure to prepare the required documentation would be considered a violation of Rule 202, Compliance With Standards [ET section 202.01], of the AICPA Code of Professional Conduct. Independence would not be considered to be impaired provided the member can demonstrate that he or she did apply safeguards to eliminate unacceptable threats or reduce them to an acceptable level. [Footnote added, effective April 30, 2006, by the Professional Ethics Executive Committee.]

This footnote reflects generally accepted auditing standards modified by the AICPA after April 16, 2003. As such, this footnote is not part of the standards adopted or established by the Public Company Accounting Oversight Board.

A member who performs a compilation engagement for a client should modify the compilation report to indicate a lack of independence if the member does not meet all of the conditions set out in this interpretation when providing a nonattest service to that client (see Statement on Standards for Accounting and Review Services No. 1, Compilation and Review of Financial Statements [AR section 100.19]). [Footnote added, effective December 31, 2003, by the Professional Ethics Executive Committee.]

A failure to prepare the required documentation would not impair independence, but would be considered a violation of Rule 202 - Compliance with Standards, provided that the member did establish the understanding with the client. [Footnote added, effective December 31, 2003, by the Professional Ethics Executive Committee. Footnote subsequently revised January 27, 2005.]

However, upon the acceptance of an attest engagement, the member should prepare written documentation demonstrating his or her compliance with the other general requirements during the period covered by the financial statements, including the requirement to establish an understanding with the client. [Footnote added, effective October 31, 2004, by the Professional Ethics Executive Committee.]

Source documents are the documents upon which evidence of an accounting transaction are initially recorded. Source documents are often followed by the creation of many additional records and reports, which do not, however, qualify as initial recordings. Examples of source documents are purchase orders, payroll time cards, and customer orders. [Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered and revised, September 2003, by the Professional Ethics Executive Committee. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2004.]

Although this type of transaction may be considered by some to be similar to signing checks or disbursing funds, the Professional Ethics Executive Committee concluded that making electronic payroll tax payments under the specified criteria would not impair a member’s independence. [Footnote renumbered by the
When auditing plans subject to the Employee Retirement Income Security Act (ERISA), Department of Labor (DOL) regulations, which may be more restrictive, must be followed. [Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, September 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2004.]

Examples of such services may include appraisal, valuation, and actuarial services performed for tax planning or tax compliance, estate and gift taxation, and divorce proceedings. [Footnote added, effective December 31, 2003, by the Professional Ethics Executive Committee. Footnote renumbered by the Professional Ethics Executive Committee, July 2004.]

For example, a member may assess whether performance is in compliance with management's policies and procedures, to identify opportunities for improvement, and to develop recommendations for improvement or further action for management consideration and decision making. [Footnote added, effective December 31, 2003, by the Professional Ethics Executive Committee. Footnote renumbered by the Professional Ethics Executive Committee, July 2004.]

As part of its responsibility to establish and maintain internal control, management monitors internal control to assess the quality of its performance over time. Monitoring can be accomplished through ongoing activities, separate evaluations, or a combination of both. Ongoing monitoring activities are the procedures designed to assess the quality of internal control performance over time and built into the normal recurring activities of an entity; they include regular management and supervisory activities, comparisons, reconciliations, and other routine actions. Separate evaluations focus on the continued effectiveness of a client's internal control. A member's independence would not be impaired by the performance of separate evaluations of the effectiveness of a client's internal control, including separate evaluations of the client's ongoing monitoring activities. [Footnote added, effective December 31, 2003, by the Professional Ethics Executive Committee. Footnote renumbered by the Professional Ethics Executive Committee, July 2004.]

The value of the collateral securing a home mortgage or other secured loan should equal or exceed the remaining balance of the grandfathered loan during the term of the loan. If the value of the collateral is less than the remaining balance of the grandfathered loan, the portion of the loan that exceeds the value of the collateral must not be material to the covered member's net worth. [Footnote added, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, September 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2004.]

Changes in the terms of the loan include, but are not limited to, a new or extended maturity date, a new interest rate or formula, revised collateral, or revised or waived covenants. [Footnote added, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, September 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2004.]

This sentence reflects revisions made to the AICPA Code of Professional Conduct after April 16, 2003. As such, this sentence is not part of the standards adopted or established by the Public Company Accounting Oversight Board.

Because of the complexities of litigation and the circumstances under which it may arise, it is not possible to prescribe meaningful criteria for measuring materiality; accordingly, the covered member should consider the nature of the controversy underlying the litigation and all other relevant factors in reaching a judgment. [Footnote renumbered and revised, July 2002, to reflect conforming changes necessary due to


[fn 19 Except for a financial reporting entity's basic financial statements, which is defined within the text of this Interpretation, certain terminology used throughout the Interpretation is specifically defined by the Governmental Accounting Standards Board. [Footnote renumbered, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Footnote subsequently renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, September 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2004.]


[fn 22 As defined in the SSAEs. [Footnote renumbered, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Footnote subsequently renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, September 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2004.]

[fn 23 Terms shown in boldface type upon first usage in this interpretation are defined in ET section 92, Definitions. [Footnote added, November 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]}

[fn 23 For purposes of this Interpretation, significant influence means having the ability to exercise significant influence over the financial, operating or accounting policies of the entity, for example by (1) being connected with the entity as a promoter, underwriter, voting trustee, general partner or director, (2) being in a policy-making position such as chief executive officer, chief operating officer, chief financial officer or chief accounting officer, or (3) meeting the criteria in Accounting Principles Board Opinion No. 18 [AC section 182] and its interpretations to determine the ability of an investor to exercise such influence with respect to an entity. The foregoing examples are not necessarily all-inclusive. [Footnote added, November 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, September 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2004.]}

[fn 24 For purposes of this Interpretation, significant influence means having the ability to exercise significant influence over the financial, operating or accounting policies of the entity, for example by (1) being connected with the entity as a promoter, underwriter, voting trustee, general partner or director, (2) being in a policy-making position such as chief executive officer, chief operating officer, chief financial officer or chief accounting officer, or (3) meeting the criteria in Accounting Principles Board Opinion No. 18 [AC section 182] and its interpretations to determine the ability of an investor to exercise such influence with respect to an entity. The foregoing examples are not necessarily all-inclusive. [Footnote added, November 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of]
For purposes of this Interpretation, significant influence means having the ability to exercise significant influence over the financial, operating or accounting policies of the entity, for example by (1) being connected with the entity as a promoter, underwriter, voting trustee, general partner or director, (2) being in a policy-making position such as chief executive officer, chief operating officer, chief financial officer or chief accounting officer, or (3) meeting the criteria in Accounting Principles Board Opinion No. 18 [AC section I82] and its interpretations to determine the ability of an investor to exercise such influence with respect to an entity. The foregoing examples are not necessarily all-inclusive. [Footnote added, November 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, September 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2004.]

When used herein, the term control includes situations where the covered member, individually or acting together with his or her firm or with other partners or professional employees of his or her firm, has the ability to exercise such control. [Footnote added, November 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, September 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2004.]

To determine if the mutual fund is diversified, the covered member should refer to (1) the mutual fund’s prospectus to see if the prospectus discloses that the fund is not diversified or (2) Section 5(b)(1) of the Investment Company Act of 1940. [Footnote added, November 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, September 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2004.]

A covered member who is an employee of a governmental organization that is required by law or regulation to audit a retirement plan sponsored by a governmental unit will be permitted to be a participant in the plan, provided the plan is offered to all employees in equivalent employment positions, and the covered member (1) is not associated with the plan in any capacity prohibited by interpretation 101-1.C; (2) has no influence or control over the investment strategy, benefits, or other management activities associated with the plan; and (3) is required to participate in the plan as a condition of employment. [Footnote added, November 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, September 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2004.]

However, a covered member who is an employee of a governmental organization that is required by law or regulation to audit a Section 529 plan sponsored by a governmental unit will be permitted to be an account owner in the plan for a period not to exceed one year from the effective date of this interpretation. [Footnote added, November 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, September 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2004.]

In April 2006, the Professional Ethics Executive Committee (PEEC) of the AICPA issued the Conceptual Framework for AICPA Independence Standards (Conceptual Framework) [ET section 100.01], which describes the risk-based approach to analyzing independence matters that is used by PEEC when it develops independence standards. Consequently, this interpretation has been revised in the "Other Considerations" section to reflect the issuance of the Conceptual Framework. Because the Conceptual Framework [ET section 100.01] is effective April 30, 2007, with earlier application encouraged, the revisions made in the "Other Considerations" section of this interpretation are also effective April 30, 2007, with earlier application encouraged.
Integrity and Objectivity

.01

Rule 102—Integrity and objectivity. In the performance of any professional service, a member shall maintain objectivity and integrity, shall be free of conflicts of interest, and shall not knowingly misrepresent facts or subordinate his or her judgment to others.

[As adopted January 12, 1988.]

Interpretations under Rule 102

—Integrity and Objectivity

.02

102-1—Knowing misrepresentations in the preparation of financial statements or records. A member shall be considered to have knowingly misrepresented facts in violation of rule 102 [ET section 102.01] when he or she knowingly—

a. Makes, or permits or directs another to make, materially false and misleading entries in an entity's financial statements or records; or

b. Fails to correct an entity's financial statements or records that are materially false and misleading when he or she has the authority to record an entry; or

c. Signs, or permits or directs another to sign, a document containing materially false and misleading information.

[Revised, effective May 31, 1999, by the Professional Ethics Executive Committee.]

.03

102-2—Conflicts of interest. A conflict of interest may occur if a member performs a professional service for a client or employer and the member or his or her firm has a relationship with another person, entity, product, or service that could, in the member's professional judgment, be viewed by the client, employer, or other appropriate parties as impairing the member's objectivity. If the member believes that the professional service can be performed with objectivity, and the relationship is disclosed to and consent is obtained from such client, employer, or other appropriate parties, the rule shall not operate to prohibit the performance of the professional service. When making the disclosure, the member should consider Rule 301, Confidential Client Information [ET section 301.01].

Certain professional engagements, such as audits, reviews, and other attest services, require independence. Independence impairments under rule 101 [ET section 101.01], its interpretations, and rulings cannot be eliminated by such disclosure and consent. The following are examples, not all-inclusive, of situations that should cause a member to consider whether or not the client, employer, or other appropriate parties could view the relationship as impairing the member's objectivity:

- A member has been asked to perform litigation services for the plaintiff in connection with a lawsuit filed against a client of the member's firm.
- A member has provided tax or personal financial planning (PFP) services for a married couple who are undergoing a divorce, and the member has been asked to provide the services for both parties during the divorce proceedings.
- In connection with a PFP engagement, a member plans to suggest that the client invest in a business in which he or she has a financial interest.
• A member provides tax or PFP services for several members of a family who may have opposing interests.
• A member has a significant financial interest, is a member of management, or is in a position of influence in a company that is a major competitor of a client for which the member performs management consulting services.
• A member serves on a city's board of tax appeals, which considers matters involving several of the member's tax clients.
• A member has been approached to provide services in connection with the purchase of real estate from a client of the member's firm.
• A member refers a PFP or tax client to an insurance broker or other service provider, which refers clients to the member under an exclusive arrangement to do so.
• A member recommends or refers a client to a service bureau in which the member or partner(s) in the member's firm hold material financial interest(s).

The above examples are not intended to be all-inclusive.

[Replaces previous interpretation 102-2, Conflicts of Interest, August 1995, effective August 31, 1995.]

.04

102-3—Obligations of a member to his or her employer’s external accountant. Under rule 102 ET section 102.01, a member must maintain objectivity and integrity in the performance of a professional service. In dealing with his or her employer’s external accountant, a member must be candid and not knowingly misrepresent facts or knowingly fail to disclose material facts. This would include, for example, responding to specific inquiries for which his or her employer's external accountant requests written representation.

[Effective November 30, 1993.]

.05

102-4—Subordination of judgment by a member. Rule 102 ET section 102.01 prohibits a member from knowingly misrepresenting facts or subordinating his or her judgment when performing professional services. Under this rule, if a member and his or her supervisor have a disagreement or dispute relating to the preparation of financial statements or the recording of transactions, the member should take the following steps to ensure that the situation does not constitute a subordination of judgment: \(^\text{fn 1}\)

1. The member should consider whether (a) the entry or the failure to record a transaction in the records, or (b) the financial statement presentation or the nature or omission of disclosure in the financial statements, as proposed by the supervisor, represents the use of an acceptable alternative and does not materially misrepresent the facts. If, after appropriate research or consultation, the member concludes that the matter has authoritative support and/or does not result in a material misrepresentation, the member need do nothing further.

2. If the member concludes that the financial statements or records could be materially misstated, the member should make his or her concerns known to the appropriate higher level(s) of management within the organization (for example, the supervisor's immediate superior, senior management, the audit committee or equivalent, the board of directors, the company's owners). The member should consider documenting his or her understanding of the facts, the accounting principles involved, the application of those principles to the facts, and the parties with whom these matters were discussed.

3. If, after discussing his or her concerns with the appropriate person(s) in the organization, the member concludes that appropriate action was not taken, he or she should consider his or her continuing relationship with the employer. The member also should consider any responsibility that may exist to communicate to third parties, such as regulatory authorities or the employer's (former employer's) external accountant. In this connection, the member may wish to consult with his or her
legal counsel.

4. The member should at all times be cognizant of his or her obligations under interpretation 102-3 [ET section 102.04].

[Effective November 30, 1993.]

.06

102-5—Applicability of rule 102 to members performing educational services. Educational services (for example, teaching full- or part-time at a university, teaching a continuing professional education course, or engaging in research and scholarship) are professional services as defined in ET section 92.11, and are therefore subject to rule 102 [ET section 102.01]. Rule 102 [ET section 102.01] provides that the member shall maintain objectivity and integrity, shall be free of conflicts of interest, and shall not knowingly misrepresent facts or subordinate his or her judgment to others.

[Effective March 31, 1995.]

.07

102-6—Professional services involving client advocacy. A member or a member's firm may be requested by a client—

1. To perform tax or consulting services engagements that involve acting as an advocate for the client.

2. To act as an advocate in support of the client's position on accounting or financial reporting issues, either within the firm or outside the firm with standard setters, regulators, or others.

Services provided or actions taken pursuant to such types of client requests are professional services [ET section 92.11] governed by the Code of Professional Conduct and shall be performed in compliance with Rule 201, General Standards [ET section 201.01], Rule 202, Compliance With Standards [ET section 202.01], and Rule 203, Accounting Principles [ET section 203.01], and interpretations thereof, as applicable. Furthermore, in the performance of any professional service, a member shall comply with rule 102 [ET section 102.01], which requires maintaining objectivity and integrity and prohibits subordination of judgment to others. When performing professional services requiring independence, a member shall also comply with rule 101 [ET section 101.01] of the Code of Professional Conduct.

Moreover, there is a possibility that some requested professional services involving client advocacy may appear to stretch the bounds of performance standards, may go beyond sound and reasonable professional practice, or may compromise credibility, and thereby pose an unacceptable risk of impairing the reputation of the member and his or her firm with respect to independence, integrity, and objectivity. In such circumstances, the member and the member's firm should consider whether it is appropriate to perform the service.

[Effective August 31, 1995.]

Footnotes (ET Section 102 — Integrity and Objectivity):

fn1 A member in the practice of public accounting should refer to the Statements on Auditing Standards. For example, see SAS No. 22, Planning and Supervision [AU section 311], which discusses what the auditor should do when there are differences of opinion concerning accounting and auditing standards.
Ethics Rulings on Independence, Integrity, and Objectivity

[1.] Acceptance of a Gift

[.001 - .002]

[Deleted 1/31/06]

.002

Answer—Independence would be considered to be impaired if a covered member accepts more than a token gift from a client, even with the knowledge of the member's firm.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

2. Association Membership

.003

Question—Would independence be considered to be impaired if a member joined a trade association that is a client of the firm?

.004

Answer—Independence would not be considered to be impaired provided the member did not serve as an officer, director, or in any capacity equivalent to that of a member of management.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

[3.] Member as Signer or Cosigner of Checks

[.005–.006]

[Deleted May 1999]

[4.] Payroll Preparation Services

[.007–.008]

[Deleted May 1999]

[5.] Member as Bookkeeper

[.009–.010]
[6.] Member's Spouse as Accountant of Client

[.011–.012]

[Deleted November 2001]

[7.] Member Providing Contract Services

[.013–.014]

[Deleted May 1999]

8. Member Providing Advisory Services

.015

Question—A member provides extensive advisory services for a client. In that connection, the member attends board meetings, interprets financial statements, forecasts and other analyses, counsels on potential expansion plans and on banking relationships. Would independence be considered to be impaired under these circumstances?

.016

Answer—Independence would not be considered to be impaired because the member's role is advisory in nature.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

9. Member as Representative of Creditor's Committee

.017

Question—A member performs the following functions for a creditors' committee in control of a debtor corporation which will continue to operate under its existing management subject to extension agreements:

- Signs or co-signs checks issued by the debtor corporation.
- Signs or co-signs purchase orders in excess of established minimum amounts.
- Exercises general supervision to insure compliance with budgetary controls and pricing formulas established by management, with the consent of the creditors, as part of an overall program aimed at the liquidation of deferred indebtedness.

Would independence be considered to be impaired with respect to the debtor corporation?

.018

Answer—Independence would be considered to be impaired if any partner or professional employee of the firm performed any of the functions described, since these are considered to be management functions.
10. Member as Legislator

.019

Question—A member is an elected legislator in a local government (a city). The city manager, who is responsible for all administrative functions, is also an elected official. Would independence be considered to be impaired with respect to the city?

.020

Answer—Independence would be considered to be impaired if any partner or professional employee of the firm served as an elected legislator for a city at the same time his or her firm was engaged to perform the city's attest engagement, even though the city manager is an elected official rather than an appointee of the legislature.

11. Member Designated to Serve as Executor or Trustee

.021

Question—A member has been designated to serve as an executor or trustee of the estate of an individual who owns the majority of a client's stock. Would independence be considered to be impaired with respect to the client?

.022

Answer—The mere designation of a covered member as executor or trustee would not be considered to impair independence, however, if a covered member actually served in such capacity, independence would be considered to be impaired.

12. Member as Trustee of Charitable Foundation

.023

Question—A charitable foundation is the sole beneficiary of the estate of the foundation's deceased organizer. If a member becomes a trustee of the foundation, would independence be considered to be impaired with respect to (1) the foundation or (2) the estate?

.024

Answer—If a covered member served as trustee of the foundation, independence would be considered to be impaired with respect to both the foundation and the estate.
14. Member on Board of Federated Fund-Raising Organization

Question—A member serves as a director or officer of a United Way or similar federated fund-raising organization (the organization). Certain local charities receive funds from the organization. Would independence be considered to be impaired with respect to such charities?

Answer—Independence would be considered to be impaired if any partner or professional employee of the firm served as a director or officer of the organization and the organization exercised managerial control over the local charities. (See ethics ruling No. 93 [ET section 191.186–187] under rule 101 [ET section 101.01] for additional guidance.)

[Replaces previous ruling No. 14, Member on Board of Directors of United Fund, April 1991. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

15. Retired Partner as Director

[Deleted June 1991]

16. Member on Board of Directors of Nonprofit Social Club

Question—Would independence be considered to be impaired if a member served on the board of directors of a nonprofit social club?

Answer—Independence would be considered to be impaired if any partner or professional employee of the firm served on the board of directors since the board has ultimate responsibility for the club's affairs.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

17. Member of Social Club

Question—Would independence be considered to be impaired if a member belongs to a social club (for example, country club, tennis club) that requires him or her to acquire a pro rata share of the
club's equity or debt securities?

Answer—As long as membership in a club is essentially a social matter, a covered member's association with the club would not impair independence because such equity or debt ownership would not be considered to be a direct financial interest within the meaning of rule 101 [ET section 101.01]. Also see interpretation 101-1.C [ET section 101.02].

[Replaces previous ruling No. 17, Member as Stockholder in Country Club, February 1991. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

[18.] Member as City Council Chairman

[.035-.036]

[Deleted June 1991]

19. Member on Deferred Compensation Committee

Question—Would independence be considered to be impaired if a member served on a committee that administers a client's deferred compensation program?

Answer—Independence would be considered to be impaired if any partner or professional employee of the firm served on the committee since such service constitutes participation in the client's management functions. The partner or professional employee could however render consulting assistance without joining the committee.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

20. Member Serving on Governmental Advisory Unit

Question—A member serves on a citizens' committee which is studying possible changes in the form of a county government that the firm audits. The member also serves on a committee appointed to study the financial status of a state. Would independence be considered to be impaired with respect to a county in that state?

Answer—Independence would not be considered to be impaired with respect to the county through the member's service on either committee.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

21. Member as Director and Auditor of an Entity's Profit Sharing and Retirement Trust
Question—A member serves in the dual capacity of director of an entity and auditor of the financial statements of that entity's profit sharing and retirement trust (the trust). Would independence be considered to be impaired with respect to the trust?

Answer—Service as director of an entity constitutes participation in management functions that affect the entity's trust. Accordingly, independence would be considered to be impaired if any partner or professional of the firm served in such capacity.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

[22.] Family Relationship, Brother

[.043–.044]

[Deleted June 1991]

[23.] Family Relationship, Uncle by Marriage

[.045–.046]

[Deleted June 1991]

[24.] Family Relationship, Father

[.047–.048]

[Deleted June 1991]

[25.] Family Relationship, Son

[.049–.050]

[Deleted June 1991]

[26.] Family Relationship, Son

[.051–.052]

[Deleted June 1991]

[27.] Family Relationship, Spouse as Trustee

[.053–.054]

[Deleted June 1991]

[28.] Cash Account With Brokerage Client
29. Member as Bondholder

Question—Would independence be considered to be impaired if a member owned an immaterial amount of a municipal authority's outstanding bonds?

Answer—Ownership of a client's bonds constitute a loan to that client. Accordingly, if a covered member owned such bonds, independence would be considered to be impaired.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

30. Financial Interest by Employee

[Deleted July 1979]

31. Performance of Services for Common Interest Realty Associations (CIRAs), Including Cooperatives, Condominium Associations, Planned Unit Developments, Homeowners Associations, and Timeshare Developments

Question—A member belongs to a common interest realty association (CIRA) as the result of the ownership or lease of real estate. Would independence be considered to be impaired with respect to the CIRA?

Answer—Independence would be considered to be impaired if a covered member was a member of a CIRA unless all of the following conditions are met:

a. The CIRA performs functions similar to local governments, such as public safety, road maintenance, and utilities.

b. The covered member's annual assessment is not material to either the covered member or the CIRA's operating budgeted assessments.

c. The liquidation of the CIRA or the sale of common assets would not result in a distribution to the covered member.

d. The CIRA's creditors would not have recourse to the covered member's assets if the CIRA became insolvent.

Also see interpretation 101-1.C [ET section 101.02] for additional restrictions related to associations with a client.

If the member has a relationship with a real estate developer or management company that is
associated with the CIRA, see interpretation 102-2 [ET section 102.03] for guidance.
[Revised, effective May 31, 1998, by the Professional Ethics Executive Committee. Revised, July
2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

[32.] Mortgage Loan to Member's Corporation

[.063–.064]
[Deleted December 1991]

[33.] Member as Participant in Employee Benefit Plan

[.065–.066]
[Deleted May 1998]

[34.] Member as Auditor of Common Trust Funds

[.067–.068]
[Deleted February 1991]

[35.] Stockholder in Mutual Funds

[.069 - .070]
[Deleted 12/31/05]

[36.] Participant in Investment Club

[.071 - .072]
[Deleted 12/31/05]

[37.] Retired Partners as Co-Trustee

[.073–.074]
[Deleted November 1980]

38. Member as Co-Fiduciary With Client Bank

.075

Question—A member serves with a client bank in a co-fiduciary capacity with respect to an estate or
trust. Would independence be considered to be impaired with respect to the bank or the bank’s trust
department?

.076

Answer—Independence would not be considered to be impaired provided the assets in the estate or
trust were not material to the total assets of the bank and/or the bank’s trust department.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee. Revised, July
Financial Services Company Client Has Custody of a Member’s Assets

Question—A financial services company client (for example, insurance company, investment adviser, broker-dealer, bank, or other depository institution) has custody of a member’s assets (other than depository accounts), including retirement plan assets. Would independence be considered to be impaired?

Answer—If a covered member’s assets were held by a financial services company client, independence would not be considered to be impaired provided the services were rendered under the company’s normal terms, procedures, and requirements and any of the covered member’s assets subject to the risk of loss were immaterial to the covered member’s net worth. Risk of loss may include losses arising from the bankruptcy of or defalcation by the client but would exclude losses due to a market decline in the value of the assets. When considering the materiality of assets subject to the risk of loss, the covered member should consider the following:

- Protection provided by state or federal regulators (for example, state insurance funds)
- Private insurance or other forms of protection (for example, the Securities Investor Protection Corporation) obtained by the financial services company to protect the assets
- Protection from creditors (for example, assets held in a pooled separate account)

For guidance dealing with depository accounts, see ethics ruling No. 70 [ET section 191.140 and 141]. [Replaces previous ruling No. 41, Member as Auditor of Mutual Insurance Company, November, 1990. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Revised, effective March 31, 2003, by the Professional Ethics Executive Committee.]
[Deleted June 1991]

[44.] Past Due Billings

[Superseded by ethics ruling No. 52.]

[45.] Past Due Fees: Client in Bankruptcy

[Deleted November 1990]

[46.] Member as General Counsel

[Superseded by ethics ruling No. 51.]

[47.] Member as Auditor of Mutual Fund and Shareholder of Investment Advisor/Manager

[Deleted February 1991]

48. Faculty Member as Auditor of a Student Fund

.095

Question—A full or part-time faculty member employed by a university is asked to audit the financial statements of the Student Senate Fund. The university:

1. Acts as a collection agent for student fees and remits them to the Student Senate.
2. Requires that a university administrator approve and sign Student Senate checks.

Would independence be considered to be impaired under these circumstances?

.096

Answer—Independence would be considered to be impaired with respect to the Student Senate Fund if any partner or professional employee (individual) performed the functions described since the individual would be auditing several of the management functions performed by the university, the individual's employer.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

[49.] Investor and Investee Companies
[.097–.098]

[Superseded by interpretation 101-8.]

[50.] Family Relationship, Brother-in-Law

[.099–.100]

[Deleted June 1983]

[51.] Member Providing Legal Services

[.101–.102]

[Deleted May 1999]

52. Unpaid Fees

.103

Question—A client of the member's firm has not paid fees for previously rendered professional services. Would independence be considered to be impaired for the current year?

.104

Answer—Independence is considered to be impaired if, when the report on the client's current year is issued, billed or unbilled fees, or a note receivable arising from such fees, remain unpaid for any professional services provided more than one year prior to the date of the report.

This ruling does not apply to fees outstanding from a client in bankruptcy.

[Replaces previous ruling No. 52, Past Due Fees, November 1990. Revised, effective November 30, 1997, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

[53.] Member as Auditor of Employee Benefit Plan and Sponsoring Company

[.105–.106]

[Deleted June 1991]

[54.] Member Providing Appraisal, Valuation, or Actuarial Services

[.107–.108]

[Deleted May 1999]

[55.] Independence During Systems Implementation

[.109–.110]

[Deleted May 1999]

[56.] Executive Search
Question—A member has been asked to audit the financial statements of an employee benefit plan ("the plan") that may have one or more participating employer(s). Would independence be considered to be impaired with respect to the plan if the member had financial or other relationships with a participating employer(s)?

Answer—Independence would be considered to be impaired with respect to the plan if any partner or professional employee of the firm had significant influence over such employer, was in a key position with the employer, or was associated with the employer as a promoter, underwriter, or voting trustee.

When auditing plans subject to the Employee Retirement Income Security Act of 1974 (ERISA), Department of Labor (DOL) regulations must be followed. fn1 [Replaces previous ruling No. 60, Employee Benefit Plans—Member's Relationships With Participating Employer(s), November 1993. Revised, effective November 30, 2001, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]
63. Review of Prospective Financial Information—Member’s Independence of Promoters

64. Member Serves on Board of Organization for Which Client Raises Funds

Question—A member serves on the board of directors of an organization. A fund-raising foundation functions solely to raise funds for that organization. Would independence be considered to be impaired with respect to the fund-raising foundation?

Answer—Independence would be considered to be impaired with respect to the fund-raising foundation if any partner or professional employee of the firm served on the organization’s board of directors. However, if the directorship were clearly honorary (in accordance with ET section 101.06, Honorary directorships and trusteeships of not-for-profit organization), independence would not be considered to be impaired.

65. Use of the CPA Designation by Member Not in Public Practice

Question—A member who is not in public practice wishes to use his or her CPA designation in connection with financial statements and correspondence of the member’s employer. The member also wants to use the CPA designation along with employment title on business cards. Is it permissible for the member to use the CPA designation in these manners?

Answer—Yes. However, if the member uses the CPA designation in a manner to imply that he or she is independent of the employer, the member would be knowingly misrepresenting facts in violation of rule 102 [ET section 102.01]. Therefore, it is advisable that in any transmittal within which the member uses his or her CPA designation, he or she clearly indicate the employment title. In addition, if the member states affirmatively in any transmittal that a financial statement is presented in conformity with generally accepted accounting principles, the member is subject to rule 203 [ET section 203.01].

[Replaces previous ruling No. 65, Use of the CPA Designation by Member Not in Public Practice, February 1996, effective February 29, 1996.]
67. Servicing of Loan

Question—Would the mere servicing of a loan by a client financial institution impair independence with respect to the client?

Answer—No.

[Replaces previous ruling No. 67, Servicing of Loan, November 1993. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

68. Blind Trust

[.136 - .137]

[Deleted 12/31/05]

69. Investment With a General Partner

Question—A private, closely held entity is the general partner and controls (as defined in Generally Accepted Accounting Principles) limited partnership A. The member has a material financial interest in limited partnership A. The member’s firm has been asked to perform an attest engagement for a new limited partnership (B), which has the same general partner as limited partnership A. Would independence be considered to be impaired with respect to limited partnership B?

Answer—Because the general partner has control over limited partnership A, the covered member would be considered to have a joint closely held investment with the general partner, who has significant influence over limited partnership B, the proposed client. Accordingly, independence would be considered to be impaired with respect to limited partnership B if the covered member had a material investment in limited partnership A.

[Replaces previous ruling No. 69, Joint Investment With a Promoter and/or General Partner, April 1991, effective April 30, 1991. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

70. Member’s Depository Relationship With Client Financial Institution

Question—A member maintains checking or savings accounts, certificates of deposit, or money market accounts at a client financial institution. Would these depository relationships impair independence?

Answer—If an individual is a covered member, independence would not be considered to be impaired
provided that—

The checking accounts, savings accounts, certificates of deposit, or money market accounts were fully insured by the appropriate state or federal government deposit insurance agencies or by any other insurer; or

- The uninsured amounts, in the aggregate, were not material to the net worth of the covered member. (When insured amounts were considered material, independence would not be considered impaired provided the uninsured balance was reduced to an immaterial amount no later than 30 days from the date the uninsured amount becomes material.)

A firm’s depository relationship would not impair its independence provided that the likelihood of the financial institution experiencing financial difficulties was considered to be remote.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Revised, effective March 31, 2003, by the Professional Ethics Executive Committee.]

71. Use of Nonindependent CPA Firm on an Engagement

.142

Question—Firm A is not independent with respect to a client. Partners or professional employees of Firm A are participating on Firm B’s attest engagement team for that client. Would Firm B’s independence be considered to be impaired?

.143

Answer—Yes. The use by Firm B of partners or professional employees from Firm A as part of the attest engagement team would impair Firm B’s independence with respect to that engagement.

However, use of the work of such individuals in a manner similar to internal auditors is permissible provided that there is compliance with the Statements on Auditing Standards. Applicable literature contained in the Statements on Auditing Standards should be consulted.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

72. Member on Advisory Board of Client

.144

Question—Would service on a client’s advisory board impair independence?

.145

Answer—Independence would be considered to be impaired if any partner or professional employee of the firm served on the advisory board unless all the following criteria are met: (1) the responsibilities of the advisory board are in fact advisory in nature; (2) the advisory board has no authority to make nor does it appear to make management decisions on behalf of the client; and (3) the advisory board and those having authority to make management decisions (including the board of directors or its equivalent) are distinct groups with minimal, if any, common membership.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

[73.] Meaning of the Period of a Professional Engagement
74. Audits, Reviews, or Compilations and a Lack of Independence

Question—If a member or his or her firm is not independent with respect to a client, is it permissible to issue an audit, review, or compilation report for that client?

Answer—A member or his or her firm may not issue an audit or review report if not independent of the client. A compilation report may be issued provided that the report specifically discloses the lack of independence without giving reasons for the impairment.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

75. Membership in Client Credit Union

Question—Does membership in a client credit union impair independence?

Answer—A covered member’s association with a client credit union would not impair independence provided all of the following criteria are met:

1. The covered member individually qualifies to join the credit union (other than by virtue of the professional services provided to the client).

2. Any loans from the credit union to the covered member meet the conditions specified in interpretation 101-1.A.4 [ET section 101.02] and are made under normal lending procedures, terms, and requirements (see interpretation 101-5 [ET section 101.07]).

3. Any deposits with the credit union meet the conditions specified in ruling No. 70 [ET section 191.140–.141] under rule 101 [ET section 101.01].

Partners and professional employees may be subject to additional restrictions as described in interpretation 101-1.B [ET section 101.02].

[Effective February 28, 1992, earlier application is encouraged. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

76. Guarantee of Loan

[.152–.153]

[Deleted December 1991]

The following Ethics Ruling No. 77 reflects deletions made to the AICPA Code of Professional Conduct after April 16, 2003. As such, the following Ethics Ruling No. 77 is not part of the standards.
81. Member's Investment in a Limited Partnership

Question—A member is a limited partner in a limited partnership (LP), including a master limited partnership. A client is a general partner in the same LP. Is independence considered to be impaired with respect to (1) the LP, (2) the client, and (3) any subsidiaries of the LP?

Answer—1. A covered member's limited partnership interest in the LP is a direct financial interest in the LP that would impair independence under interpretation 101-1.A.1 [ET section 101.02].

2. The LP is an investee of the client because the client is a general partner in the LP. Therefore, under interpretation 101-8 [ET section 101.10], if the investment in the LP were material to the client, a covered member's financial interest in the LP would impair independence. However, if the client's financial interest in the LP were not material to the client, a covered member's immaterial financial interest in the LP would not impair independence.

3. If the covered member is a limited partner in the LP, the covered member is considered to have an indirect financial interest in all subsidiaries of the LP. If the indirect financial interest in the subsidiaries were material to the covered member, independence would be considered to be impaired with respect to those subsidiaries under interpretation 101-1.A.1 [ET section 101.02]. If the covered member or client general partner, individually or together can control the LP, the LP would be considered a joint closely held investment under ET section 92.16.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]
Question—A member serves as the campaign treasurer of a mayoral candidate. Would independence be considered to be impaired with respect to (1) the political party with which the candidate is associated, (2) the municipality of which the candidate may become mayor, or (3) the campaign organization?

Answer—Independence would not be considered to be impaired with respect to the political party or municipality. However, if any partner or professional employee of the firm served as campaign treasurer, independence would be considered to be impaired with respect to the campaign organization.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

83. Member on Board of Component Unit and Auditor of Oversight Entity

[Deleted January 1996]

84. Member on Board of Material Component Unit and Auditor of Another Material Component Unit

[Deleted January 1996]

85. Bank Director

Question—May a member in public practice serve as a director of a bank?

Answer—Yes; however, before accepting a bank directorship, the member should carefully consider the implications of such service if the member has clients that are customers of the bank.

These implications fall into two categories:

a. Confidential Client Information—Rule 301 [ET section 301.01] provides that a member in public practice shall not disclose any confidential client information without the specific consent of the client. This ethical requirement applies even though failure to disclose information may constitute a breach of the member's fiduciary responsibility as a director.

b. Conflicts of Interest—Interpretation 102-2 [ET section 102.03] provides that a conflict of interest may occur if a member performs a professional service (including service as a director) and the member or his or her firm has a relationship with another entity that could, in the member's professional judgment, be viewed by appropriate parties as impairing the member's objectivity. If the member believes that the professional service can be performed with objectivity and the relationship is disclosed to and consent is obtained from all appropriate parties, performance of the service shall
not be prohibited.

In view of the above factors, it is generally not desirable for a member in public practice to accept a position as bank director where the member's clients are likely to engage in significant transactions with the bank. If a member is engaged in public practice, the member should avoid the high probability of a conflict of interest and the appearance that the member's fiduciary obligations and responsibilities to the bank may conflict with or interfere with the member's ability to serve the client's interest objectively and in complete confidence.

The general knowledge and experience of CPAs in public practice may be very helpful to a bank in formulating policy matters and making business decisions; however, in most instances, it would be more appropriate for the member as part of the member's public practice to serve as a consultant to the bank's board. Under such an arrangement, the member could limit activities to those which did not involve conflicts of interest or confidentiality problems.

[86.] Partially Secured Loans

[.172–.173]

[Deleted February 1998]

[87.] Loan Commitment or Line of Credit

[.174–.175]

[Deleted February 1998]

[88.] Loans to Partnership in Which Members are Limited Partners

[.176–.177]

[Deleted February 1998]

[89.] Loan to Partnership in Which Members are General Partners

[.178–.179]

[Deleted February 1998]

[90.] Credit Card Balances and Cash Advances

[.180–.181]

[Deleted February 1998]

91. Member Leasing Property to or From a Client

.182

Question—Would independence be considered to be impaired if a member leased property to or from a client?

.183

Answer—Independence would not be considered to be impaired if the lease meets the criteria of an operating lease (as described in Generally Accepted Accounting Principles), the terms and conditions
set forth in the lease agreement are comparable with other leases of a similar nature, and all amounts are paid in accordance with the terms of the lease.

Independence would be considered to be impaired if a covered member had a lease that meets the criteria of a capital lease (as described in Generally Accepted Accounting Principles) unless the lease is in compliance with interpretations 101-1.A.4 [ET section 101.02] and 101-5 [ET section 101.07], because the lease would be considered to be a loan to or from the client.

[Revised, effective May 31, 1998, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

92. Joint Interest in Vacation Home

Question—A member has a joint interest in a vacation home with a client (or one of the client's officers or directors, or any owner who has the ability to exercise significant influence over the client). Would the vacation home constitute a "joint closely held investment" as defined in ET section 92.16?

Answer—Yes. The vacation home, even if solely intended for the personal use of the owners, would be considered a joint closely held investment as defined in ET section 92.16 if it meets the criteria described in the aforementioned definition.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

93. Service on Board of Directors of Federated Fund-Raising Organization

Question—A member serves as a director or officer of a local United Way or similar organization that operates as a federated fund-raising organization from which local charities receive funds. Some of those charities are clients of the member's firm. Does the member have a conflict of interest under rule 102 [ET section 102.01]?

Answer—Interpretation 102-2 [ET section 102.03] provides that a conflict of interest may occur if a member performs a professional service for a client and the member or his or her firm has a relationship with another entity that could, in the member's professional judgment, be viewed by the client or other appropriate parties as impairing the member's objectivity. If the member believes that the professional service can be performed with objectivity and the relationship is disclosed to and consent is obtained from the appropriate parties, performance of the service shall not be prohibited. (If the service being provided is an attest engagement, consult ethics ruling No. 14 [ET section 191.027- .028] under rule 101 [ET section 101.01]).

[Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

94. Indemnification Clause in Engagement Letters

Question—A member or his or her firm proposes to include in engagement letters a clause that provides that the client would release, indemnify, defend, and hold the member (and his or her
partners, heirs, executors, personal representatives, successors, and assigns) harmless from any liability and costs resulting from knowing misrepresentations by management. Would inclusion of such an indemnification clause in engagement letters impair independence?

Answer—No.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

95. Agreement With Attest Client to Use ADR Techniques

Question—Alternative dispute resolution (ADR) techniques are used to resolve disputes (in lieu of litigation) relating to past services, but are not used as a substitute for the exercise of professional judgment for current services. Would a predispute agreement to use ADR techniques between a member or his or her firm and a client cause independence to be impaired?

Answer—No. Such an agreement would not cause independence to be impaired since the member (or the firm) and the client would not be in threatened or actual positions of material adverse interests by reason of threatened or actual litigation.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

96. Commencement of ADR Proceeding

Question—Would the commencement of an alternative dispute resolution (ADR) proceeding impair independence?

Answer—Except as stated in the next sentence, independence would not be considered to be impaired because many of the ADR techniques designed to facilitate negotiation and the actual conduct of those negotiations do not place the member or his or her firm and the client in threatened or actual positions of material adverse interests. Nevertheless, if a covered member and the client are in a position of material adverse interests because the ADR proceedings are sufficiently similar to litigation, ethics interpretation 101-6 [ET section 101.08] should be applied. Such a position would exist if binding arbitration were used.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

[97.] Performance of Certain Extended Audit Services

[.194-.195]

[Deleted August 1996]
98. Member's Loan From a Nonclient Subsidiary or Parent of an Attest Client

Question—A member has obtained a loan from a nonclient. The member's firm performs an attest engagement for the parent or a subsidiary of the nonclient. Does the loan from the nonclient subsidiary or parent impair independence?

Answer—A covered member's loan that is not a “grandfathered” or “permitted” loan under interpretation 101-5 [ET section 101.07] from a nonclient subsidiary would impair independence with respect to the client parent. However, a loan from a nonclient parent would not impair independence with respect to the client subsidiary as long as the subsidiary is not material to its parent.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

99. Member Providing Services for Company Executives

Question—A member has been approached by a company, for which he or she may or may not perform other professional services, to provide personal financial planning or tax services for its executives. The executives are aware of the company's relationship with the member, if any, and have also consented to the arrangement. The performance of the services could result in the member recommending to the executives actions that may be adverse to the company. What rules of conduct should the member consider before accepting and during the performance of the engagement?

Answer—Before accepting and during the performance of the engagement, the member should consider the applicability of Rule 102, Integrity and Objectivity [ET section 102.01]. If the member believes that he or she can perform the personal financial planning or tax services with objectivity, the member would not be prohibited from accepting the engagement. The member should also consider informing the company and the executives of possible results of the engagement. During the performance of the services, the member should consider his or her professional responsibility to the clients (that is, the company and the executives) under Rule 301, Confidential Client Information [ET section 301.01].

100. Actions Permitted When Independence Is Impaired

Question—If a member or a member's firm (member) was independent when its report was initially issued, may the member re-sign the report or consent to its use at a later date when his or her independence is considered to be impaired?

Answer—Yes. A member may re-sign the report or consent to its use at a later date when his or her independence is considered to be impaired, provided that no “post-audit work” is performed by the member during the period of impairment. The term “post-audit work,” in this context, does not include inquiries of successor auditors, reading of subsequent financial statements, or such procedures as may be necessary to assess the effect of subsequently discovered facts on the financial statements.
covered by the member’s previously issued report.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

101. Client Advocacy and Expert Witness Services

.202

Question—Would the performance of expert witness services be considered as acting as an advocate for a client as discussed in interpretation 102-6 [ET section 102.07]? .203

Answer—No. A member serving as an expert witness does not serve as an advocate but as someone with specialized knowledge, training, and experience in a particular area who should arrive at and present positions objectively.

102. Indemnification of a Client

.204

Question—As a condition to retaining a member or his or her firm to perform an attest engagement, a client or prospective client requests that the member (or the firm) enter into an agreement providing, among other things, that the member (or the firm) indemnify the client for damages, losses, or costs arising from lawsuits, claims, or settlements that relate, directly or indirectly, to client acts. Would entering into such an agreement impair independence? .205

Answer—Yes. Such an agreement would impair independence under interpretation 101-1.A [ET section 101.02] and interpretation 101-1.C [ET section 101.02].

[Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

103. Attest Report on Internal Controls

.206

Question—If a member or his or her firm provides extended audit services for a client in compliance with interpretation 101-13 [ET section 101.15], would the firm be considered to be independent in the performance of an attestation engagement to report on the client’s assertion regarding the effectiveness of its internal control over financial reporting? .207

Answer—Independence would not be considered to be impaired with respect to the issuance of such a report if both of the following conditions are met:

1. Management has assumed responsibility to establish and maintain internal control.

2. Management does not rely on the firm’s work as the primary basis for its assertion and accordingly has (a) evaluated the results of its ongoing monitoring procedures built into the normal recurring activities of the entity (including regular management and supervisory activities) and (b)
evaluated the findings and results of the firm's work and other separate evaluations of controls, if any.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

*The following Ethics Ruling No. 104 reflects deletions made to the AICPA Code of Professional Conduct after April 16, 2003. As such, the following Ethics Ruling No. 104 is not part of the standards adopted or established by the Public Company Accounting Oversight Board.*

**[104.] Operational Auditing Services**

[.208–.209] [Deleted September 2003]

[Deleted September 2003]

*The following Ethics Ruling No. 105 reflects deletions made to the AICPA Code of Professional Conduct after April 16, 2003. As such, the following Ethics Ruling No. 105 is not part of the standards adopted or established by the Public Company Accounting Oversight Board.*

**[105.] Frequency of Performance of Extended Audit Procedures**

[.210–.211] [Deleted September 2003]

[Deleted September 2003]

106. **Member Has Significant Influence Over an Entity That Has Significant Influence Over a Client**

.212

*Question*—Would independence be considered to be impaired if a member or his or her firm had significant influence, as defined in *ET* section 92.27, over an entity that has significant influence over a client?

.213

*Answer*—Independence would be considered to be impaired if any partner or professional of the firm had significant influence over an entity that has significant influence over a client. By having such influence over the nonclient entity, the partner or professional employee would also be considered to have significant influence over the client.

See interpretation 101-8 [*ET* section 101.10] for further guidance.
[Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

107. **Participation in Health and Welfare Plan Sponsored by Client**

.214

*Question*—A member participates in or receives benefits from a health and welfare plan (the "plan") sponsored by a client. Would independence be considered to be impaired with respect to the client sponsor or the plan?
**Answer**—A covered member's participation in a plan sponsored by a client would impair independence with respect to the client sponsor and the plan. However, if the covered member's participation in the plan, or benefits received thereunder, arises as a result of the permitted employment of the covered member's immediate family in accordance with interpretation 101-1 [ET section 101.02], independence would not be considered to be impaired provided that the plan is normally offered to all employees in equivalent employment positions.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Revised, November 2002, by the Professional Ethics Executive Committee.]

**[108.] Participation of Member, Spouse or Dependent in Retirement, Savings, or Similar Plan Sponsored by, or That Invests in, Client**

[.216–.217]

[Deleted November 2001]

**[109.] Member's Investment in Financial Services Products That Invest in Clients**

[.218 - .219]

[Deleted 12/31/05]

**110. Member is Connected With an Entity That Has a Loan to or From a Client**

..220

**Question**—A member is associated with an entity as an officer, director, or a shareholder who is able to exercise significant influence over an entity. That entity has a loan to or from a client of the member’s firm. Would independence be considered to be impaired with respect to the client?

..221

**Answer**—If a covered member has control over the entity (as defined in Generally Accepted Accounting Principles) the existence of a loan to or from the client would impair independence unless the loan from the client is specifically permitted under interpretation 101-5 [ET section 101.07].

If any partner or professional employee of the firm is connected with the entity as an officer, director, or shareholder who is able to exercise significant influence over the entity, but is unable to control the entity, he or she should consider interpretation 102-2 [ET section 102.03]. Interpretation 102-2 provides that a conflict of interest may occur if a member performs a professional service for a client and the member or his or her firm has a relationship with another entity that could, in the member’s professional judgment, be viewed by the client or other appropriate parties as impairing the member’s objectivity. If the member believes that the professional service can be performed with objectivity, and the relationship is disclosed to and consent is obtained from such client and other appropriate parties, the rule shall not operate to prohibit the performance of the professional service.

When making the decision as to whether to perform a professional service and in making disclosure to the appropriate parties, the member should consider Rule 301, Confidential Client Information [ET section 301.01].

[Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]
**Question**—A member or his or her firm provides asset management or investment services that may include having custody of assets, performing management functions, or making management decisions for an employee benefit plan (the plan) sponsored by a client. Would independence be considered to be impaired with respect to the plan and the client sponsor?

**Answer**—The performance of investment management or custodial services for a plan would be considered to impair independence with respect to the plan. Independence would also be considered to be impaired with respect to the client sponsor of a defined benefit plan if the assets under management or in the custody of the member are material to the plan or the client sponsor.

Independence would not be considered to be impaired with respect to the client sponsor of a defined contribution plan provided the member does not make any management decisions or perform management functions on behalf of the client sponsor or have custody of the sponsor’s assets.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

**112. Use of a Third-Party Service Provider to Assist a Member in Providing Professional Services**

**Question**—A member in public practice uses an entity that the member, individually or collectively with his or her firm or with members of his or her firm, does not control (as defined by accounting principles generally accepted in the United States) or an individual not employed by the member (a third-party service provider) to assist the member in providing professional services (for example, bookkeeping, tax return preparation, consulting, or attest services, including related clerical and data entry functions) to clients. Does Rule 102, Integrity and Objectivity [ET section 102], require the member to disclose the use of the third-party service provider to the client?

**Answer**—Yes. The concept of integrity set forth in Rule 102, Integrity and Objectivity [ET section 102.01] and Article III, Integrity [ET section 54] requires a member to be honest and candid. Clients might not have an expectation that a member would use a third-party service provider to assist the member in providing the professional services. Accordingly, before disclosing confidential client information to a third-party service provider, a member should inform the client, preferably in writing, that the member may use a third-party service provider. This disclosure does not relieve the member from his or her obligations under Ethics Ruling No. 1 [ET section 391.001-.002] under Rule 301, Confidential Client Information [ET section 301.01]. If the client objects to the member’s use of a third-party service provider, the member should provide the professional services without using the third-party service provider or the member should decline the engagement.

A member is not required to inform the client when he or she uses a third-party service provider to provide administrative support services (for example, record storage, software application hosting, or authorized e-file tax transmittal services) to the member.

See Ethics Ruling No. 12 under Rule 201, General Standards, and Rule 202, Compliance With Standards [ET section 291.023-.024]; and Ethics Ruling No. 1 under Rule 301, Confidential Client Information [ET section 391.001-.002], for additional responsibilities of the member when using a third-party service provider.

**113. Acceptance or Offering of Gifts or Entertainment**

**Question**—Would objectivity or integrity be considered to be impaired if a member offers or accepts gifts or entertainment to or from a client (or an individual in a key position with a client) or an individual
owning 10 percent or more of the client’s outstanding equity securities or other ownership interests),
or a customer or vendor of the member’s employer (or a representative of the customer or vendor)?

Answer—Objectivity would be considered to be impaired unless the gift or entertainment is reasonable in the circumstances.

The member should exercise judgment in determining whether gifts or entertainment would be considered reasonable in the circumstances. Relevant facts and circumstances would include, but are not limited to:

- The nature of the gift or entertainment
- The occasion giving rise to the gift or entertainment
- The cost or value of the gift or entertainment
- The nature, frequency, and value of other gifts and entertainment offered or accepted
- Whether the entertainment was associated with the active conduct of business either directly before, during, or after the entertainment
- Whether other clients, customers, or vendors also participated in the entertainment
- The individuals from the client, customer, or vendor and the member’s firm or employer who participated in the entertainment

In addition, a member would be presumed to lack integrity if he or she accepted or offered gifts or entertainment that he or she knew or was reckless in not knowing would violate the member, client, customer, or vendor’s policies or applicable laws and regulations.

See Ethics Ruling No. 114, “Acceptance or Offering of Gifts and Entertainment to or From an Attest Client,” of ET section 191, Ethics Rulings on Independence, Integrity, and Objectivity (AICPA, Professional Standards, vol. 2, ET sec. 191.228-.229), for guidance applicable to the offer or acceptance of gifts or entertainment to or from an attest client.

114. Acceptance or Offering of Gifts and Entertainment to or From an Attest Client

Question—Would independence be considered to be impaired if a member or the member’s firm offers or accepts gifts or entertainment to or from an attest client, an individual in a key position with an attest client, or an individual owning 10 percent or more of the attest client’s outstanding equity securities or other ownership interests (collectively, an attest client)?

Answer—Independence would be considered to be impaired if the member’s firm or a member on the attest engagement team or in a position to influence the attest engagement accepts a gift from an attest client, unless the value is clearly insignificant to the recipient. Independence would not be considered to be impaired if a covered member accepts entertainment from an attest client, provided the entertainment is reasonable in the circumstances.

Independence would not be considered to be impaired if a covered member offers gifts or entertainment to an attest client, provided the gift or entertainment is reasonable in the circumstances.

See Ethics Ruling No. 113, “Acceptance or Offering of Gifts or Entertainment,” of ET section 191, Ethics Rulings on Independence, Integrity, and Objectivity (AICPA, Professional Standards, vol. 2, ET sec. 191.226-.227), for criteria a member should consider in determining whether the gifts or entertainment would be considered reasonable in the circumstances.
Rule 503—Commissions and referral fees.

A. Prohibited commissions

A member in public practice shall not for a commission recommend or refer to a client any product or service, or for a commission recommend or refer any product or service to
be supplied by a client, or receive a commission, when the member or the member's firm also performs for that client
(a) an audit or review of a financial statement; or

(b) a compilation of a financial statement when the member expects, or reasonably might expect, that a third party will use the financial statement and the member's compilation report does not disclose a lack of independence; or

(c) an examination of prospective financial information.

This prohibition applies during the period in which the member is engaged to perform any of the services listed above and the period covered by any historical financial statements involved in such listed services.

B. Disclosure of permitted commissions

A member in public practice who is not prohibited by this rule from performing services for or receiving a commission and who is paid or expects to be paid a commission shall disclose that fact to any person or entity to whom the member recommends or refers a product or service to which the commission relates.

C. Referral fees

Any member who accepts a referral fee for recommending or referring any service of a CPA to any person or entity or who pays a referral fee to obtain a client shall disclose such acceptance or payment to the client.

[As adopted May 23, 1990, effective August 9, 1990.]
Interpretation under Rule 503

—Commissions and Referral Fees

[.02]

[503-1]—[Deleted]
Advertising and Other Forms of Solicitation

.01

Rule 502—Advertising and other forms of solicitation. A member in public practice shall not seek to obtain clients by advertising or other forms of solicitation in a manner that is false, misleading, or deceptive. Solicitation by the use of coercion, over-reaching, or harassing conduct is prohibited.

[As adopted January 12, 1988.]
Interpretations under Rule 502

—Advertising and Other Forms of Solicitation

[.02]

[502-1]—[Deleted]

[03]

502-2—False, misleading or deceptive acts in advertising or solicitation. Advertising or other forms of solicitation that are false, misleading, or deceptive are not in the public interest and are prohibited. Such activities include those that—

1. Create false or unjustified expectations of favorable results.

2. Imply the ability to influence any court, tribunal, regulatory agency, or similar body or official.

3. Contain a representation that specific professional services in current or future periods will be performed for a stated fee, estimated fee or fee range when it was likely at the time of the representation that such fees would be substantially increased and the prospective client was not advised of that likelihood.

4. Contain any other representations that would be likely to cause a reasonable person to misunderstand or be deceived.

[Revised, November 30, 1990, by the Professional Ethics Executive Committee.]

[.04]

[502-3]—[Deleted]
.05

502-4—[Deleted]

.06

502-5—Engagements obtained through efforts of third parties.  Members are often asked to render professional services to clients or customers of third parties. Such third parties may have obtained such clients or customers as the result of their advertising and solicitation efforts.

Members are permitted to enter into such engagements. The member has the responsibility to ascertain that all promotional efforts are within the bounds of the Rules of Conduct. Such action is required because the members will receive the benefits of such efforts by third parties, and members must not do through others what they are prohibited from doing themselves by the Rules of Conduct.